Focus

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Introducing Savings in Microcredit Institutions: When and How?

The Focus Series is CGAP's primary vehicle for dissemination to governments, donors, and private and financial institutions on best practices in microenterprise finance.

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Voluntary deposits as a source of commercial finance for microcredit institutions, has generated a lot of interest and debate in recent years. Locally mobilized voluntary savings is potentially the largest and the most immediately available source of finance for some microcredit institutions. Another important reason for undertaking the institutional mobilization of voluntary savings is the vast unmet demand for institutional savings services at the local levels of developing countries. The purpose of this paper is to broaden the discussion of when and how a microcredit institution should mobilize voluntary savings from the public. Getting these elements right is a crucial part of meeting the demand.

When?

Three conditions dominate the issue of when a microcredit institution should start mobilizing voluntary savings — some of which are beyond the control of the institution. First, profitable mobilization of voluntary savings requires an enabling macro-economy, an appropriate legal and regulatory environment, reasonable level of political stability, and suitable demographic conditions. The second consideration concerns the supervision of institutions providing microfinance. For the protection of their clients, especially depositors, financial institutions that mobilize voluntary savings should come under government supervision. This, of course, requires a government that is willing to modify its banking supervision so that the rules for microcredit institutions are appropriate for their activities, and to ensure that the supervisory body is able to monitor these institutions *effectively*. The third consideration concerns the history, capability, and performance of the institution. Before mobilizing voluntary public savings, a microcredit institution should have demonstrated consistently good management of its own funds. In other words, it should be financially solvent with a high rate of loan recovery, earning attractive returns. This established record is important because in many countries low-income people who have entrusted their savings to small unsupervised financial institutions have lost their lifetime savings.

If an MFI is ready, but the country is not...

There are circumstances in which microcredit institutions are qualified and ready to start mobilizing voluntary savings, but the country in which they operate does not have the appropriate legal, regulatory, and supervisory structures. In this case, microcredit institutions and donors should concentrate on bringing these issues, as well as the lessons of international experience in microfinance to the attention of the regulatory authorities. The messages should be: (a) introduce regulations (or more likely deregulation) regarding interest rates, capital requirements, salary levels, and other

factors that enable microfinance institutions (MFIs) to provide financial services profitably; and (b) do not permit unqualified institutions to mobilize public savings, nor allow more institutions to mobilize savings than the supervisory body is able to supervise effectively.

Microcredit institutions that need to convince their respective authorities about the necessary changes must familiarize themselves with international and country-specific experience and evidence to support their arguments. They should also conduct market research on the demand for savings instruments in their own markets, as has been done by institutions such as Bank Rakyat Indonesia (BRI), PRODEM and BancoSol in Bolivia, and the Kenya Rural Enterprise Programme.

There is substantial empirical evidence that institutional savings that offer security, convenience, liquidity, confidentiality, and returns to the depositor, represent a crucial financial service for poor clients; if priced correctly, voluntary savings can contribute to the institution's self-sufficiency and outreach. The introduction of commercial microfinance is likely to have some level of political visibility nearly everywhere, and the probability becomes higher when voluntary savings instruments are added, since both the institution's outreach and visibility increase. Therefore, a microcredit institution that plans to pursue deposit mobilization will need political support at both the local and national levels.

How?

The discussion below about how a financial institution can mobilize voluntary deposits at the local level assumes that the country has the enabling macro-economic, regulatory, and political characteristics discussed above, and that there is a sufficient density of population to allow for profitable financial intermediation. It assumes further that the organization is either a financially viable microcredit institution with a well-performing loan portfolio, or a commercial bank that has decided to enter the microfinance market. Such institutions should consider carefully the issues raised below.

A. Adding voluntary savings to a microcredit program will fundamentally change the program.

The institution should be prepared for these changes and should not believe that adding savings is like adding "just another product." In countries with large, unmet demand for savings services, MFIs that offer loans and well-designed savings instruments have many more deposit accounts than loans. At BRI's local banking system, there are about six times as many deposit accounts as loans. At Bank Dagang Bali, the ratio of savings to loan accounts is over 30 to 1. This pattern occurs primarily because most micro-finance clients want to save all the time, while most want to borrow only some of the time.

The introduction of voluntary savings services thus implies the addition of many new customers — which in turn means increases in staff, management, offices, systems, communications, staff training, security, and changes in other operational aspects for the MFI. Job descriptions and staff training requirements change since staff must become *financial intermediators* instead of loan officers. The criteria for staff evaluation and promotion changes, as do requirements for cash management and security systems, and for accounting, reporting, and supervision systems. Moreover, interest rates on loans may have to be changed to ensure that the spread between interest rates for loans and deposits is sufficient to cover all costs and to return a profit.

B. Compulsory savings and voluntary savings are incompatible.

The requirement of compulsory savings and the mobilization of voluntary savings reflect two very different philosophies. The former assumes that the poor must be taught to save, and that they need to learn financial discipline. The latter assumes that the working poor already save, and that what is required are institutions and services appropriate to their needs. Microfinance clients may not feel comfortable putting voluntary savings accounts in compulsory savings accounts, or even in other accounts with the same institution. They know they cannot withdraw the compulsory savings until their loan is repaid (or after a certain number of years), and they fear that they may also not have easy access, *de facto,* to their voluntary savings.

Although BRI's local banking division (also known as BRI's village banking or unit *desa* system) incorporates a 'prompt payment incentive,' which is a type of compulsory savings, this is treated as a loan guarantee — not as savings. For example, under this system a borrower makes a monthly payment of 25 percent of his or her monthly interest payment; this amount is returned to those who repay the loan on time. BRI's borrowers as well as many other savers also hold savings accounts in the unit *desas*, but these accounts are voluntary. Savers know that they have access to the funds in these accounts according to the terms of the particular savings instruments.

There are two lessons here. First, savings and loans should be kept separate. Second, the institution should not try to teach its clients how to save. Instead, the MFI should concentrate on teaching its staff how to provide the instruments and services that will capture these savings. The lesson learned in mobilizing savings is to train the staff, not the clients!

C. Products should be designed and priced together.

An institution aiming at full self-sufficiency must, of course, set a spread between loan and deposit rates that enables institutional profitability. However, adjusting the interest rates requires some experimentation. For example, a savings instrument that features easy and quick access (liquidity) and is in high demand can be labor-intensive to manage. It is, therefore, costly to an MFI, especially if there are a large number of very small accounts. Experience indicates that most savers who select liquid accounts are not highly interest rate sensitive, generally preferring better service to higher interest rates. Labor and other non-financial costs must be considered when setting interest rates on deposits. These costs are difficult to determine in advance, so pilot-tests are needed to estimate cost accurately.

The introduction of voluntary savings will also require some changes on the lending side. For example, if the MFI offers only group loans, it should consider introducing individual loans to its portfolio. This addition is needed because potential savings customers are likely to say, "I have US$100 to deposit. When I need a loan, how much will I be able to borrow?" If the answer is: "First you must form a group, and then you may be eligible for a US$50 loan," it is likely that the deposit will be lost. Successful group loans can and should, of course, be continued, but it may become necessary to add individual loans.

Finally, limits on loan sizes will have to be increased when deposit services are added. An institution using deposits for on-lending has to meet the demand of both borrowers and savers. Larger savers tend to qualify for and want larger loans. Borrowers who are forced out by the institution's loan limits before they can qualify for loans from commercial banks find themselves in difficulty. In contrast, MFIs that help long-term borrowers to obtain larger loans and recommend them to other banks when they qualify will continue to have the client's goodwill, and at least some of their savings. Bank Dagang Bali retains its good borrowers, offering them increasingly larger loans as their enterprises grow. Eventually some of these borrowers find better loan terms elsewhere, but they usually remain savers in Bank Dagang Bali.

D. Deposit instruments should be appropriate for local demand.

The common denominator in Bank Dagang Bali, BRI's Unit Desa system, and BancoSol is that their savings services meet specific local demands for security, convenience of location, and a choice of instruments with different mixes of liquidity and returns. In the case of BRI, the same banking system that mobilized US$17.6 million in its first ten years of operation (1973-83), mobilized US$3 billion from 1984 to 1996. This spectacular change occurred because after the first decade, the bank had an incentive to mobilize savings, and therefore began to learn about the local markets it serves. Deposit instruments were then designed specifically to meet different types of local demand. As of December 1996, there were 16.1 million savings accounts in BRI's unit *desa* system.

E. There is substantial need to develop human resources.

Managing a financial intermediary is more complex than managing a credit operation, especially since the size of the organization tends to increase rapidly. Training for staff and management becomes an urgent need. For commercial banks venturing into the microfinance market, the tendency to down-load commercial and corporate banking instruments, spreads, training, and attitudes must be assiduously avoided. Bank staff must also learn to treat poor cli-

ents with respect, a lesson that comes hard to some bankers.

Staff at microcredit institutions often need to change their perception about their clients. They need to understand that the working poor save, and that these savings can finance a large volume of loans. As with training on 'best practice' lending operations, evidence indicates that methods of staff training about local demand for savings services, locating potential clients, and designing attractive instruments transfer well between countries.

F. New marketing strategies will have to be developed.

For credit services, the MFI selects borrowers who are trusted by the institution. In savings mobilization, however, it is the customer who must trust the MFI. The institution must first arrange to provide its savers with quality savings services — and then publicize its instruments and services in locally appropriate ways.

The key is to learn from clients what they want and then incorporate this information into both the product and advertising. For example, BRI's most liquid savings account (called SIMPEDES) featuring both interest and lotteries was an instant success because extensive research had been done on what features customers wanted in a liquid instrument and why they wanted these. This information was then used both in the design of the instrument and in advertising messages. Moreover, BRI conducted market research to determine what kind of lottery prizes were popular, what kind of bank book was wanted, and what kinds of publicity were effective. The results were excellent. By December of 1996, SIMPEDES and its urban counterpart SIMASKOT accounted for 76 percent of total deposits in BRI's Unit Desa system.

G. Careful attention must be paid to sequencing.

The following steps are relevant to many microcredit institutions that are planning to introduce voluntary savings.

1. Enhance the knowledge of the institution's board and managers on the experience of other MFIs with regard to voluntary savings mobilization.
2. Carry out market research and train staff selected for the pilot phase.
3. Conduct and evaluate a pilot project (a crucial step because, until the extent of the demand and costs of different products, including labor, are known, only temporary interest rates can be set).
4. Where necessary, second pilots should be carried out and evaluated. During this period, attention should also be given to planning, logistics, management information systems, and wider staff training, in order to prepare for expansion of the savings program.
5. The institution is now ready to gradually expand savings services throughout its branches.
6. After successful expansion, the emphasis should switch from the logistics of expansion to the techniques of market penetration. The former is a necessary, but not a sufficient condition for massive deposit mobilization. Well-run institutions that offer appropriate deposit facilities and services can quickly gain access to the accounts of people living or working near the MFI's offices. Market penetration of a wider service area, however, requires other methods. These include: the development of a systematic approach to the identification of potential depositors; implementation of a staff incentive system based on performance; development of effective methods for communication within the MFI; more market research; overhauling public relations; and massive staff training.

The sequencing outlined above may appear lengthy and cumbersome, but instituting a voluntary savings program is a prime illustration of 'haste makes waste.' An MFI that does it the wrong way will lose the trust of its clients, and eventually its own viability.

Getting right the 'when' and the 'how' of introducing voluntary savings mobilization enables MFIs to meet local demand for savings services and to provide a larger volume of microcredit, thereby increasing both outreach and profitability.

This note is a synopsis of a paper by Marguerite S. Robinson, Institute Fellow at Harvard University's Institute for International Development (HIID) titled *Introducing Savings Mobilization in Micro-finance Programs: When and How?* The paper is based on a talk given at the annual meeting of the MicroFinance Network held in the Philippines in November 1995. It is available from HIID, One Eliot Street, Cambridge, MA 02138, USA; telephone (617) 495-2161; fax (617) 495-0527. The synopsis was done by Joyita Mukherjee of the CGAP Secretariat.

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