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SAVINGS – AN ESSENTIAL SERVICE FOR THE POOR



OPTIMISING PERFORMANCE AND EFFICIENCY SERIES

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Presents

OPTIMISING PERFORMANCE AND EFFICIENCY SERIES

SAVINGS – AN ESSENTIAL SERVICE FOR THE POOR

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SAVINGS – AN ESSENTIAL SERVICE FOR THE POOR



Throughout time, all around the world, households have saved as insurance against emergencies, for religious and social obligations, for investment and for future consumption. The importance the poor attach to savings is also demonstrated by the many ingenious (but often costly) ways they find to save. But for a variety of reasons, most informal mechanisms fail to meet the needs of the poor in a convenient, cost-effective and secure manner. As a consequence, when poor households are provided a safe, easily accessible opportunity to save, their commitment to saving, and the amounts they manage to save, are remarkable.

Increasingly, Microfinance Institutions (MFIs) have come to recognise the need to provide savings services – both as a much valued service to their clients, and as a long-term source of capital. This has led to growing interest in savings, Vogel’s “forgotten half” of microfinance.

It is clear, and now generally accepted, that poor people want, need and do indeed save. There is also increasing evidence that poor people are facing an extremely risky environment when they save in the informal sector. Thus, it is clear that when discussing the risk to poor people’s savings, this has to be evaluated on a relative basis. Very often, all the alternative savings systems available to poor people are risky ... thus poor people are left facing decisions on the **relative risk** (or relative security/safety) of the various semi- and informal savings systems open to them.

Practitioners estimate that savers stranded in the informal sector lose between 15 to 25% of their savings annually. Research from Uganda revealed that 99% of clients saving in the informal sector report that they have lost some of their savings and on average they had lost 22% of the amount they had saved in the last year. In other words, for the poor savings are nearly as costly as a loan from an MFI: over the year, they “pay” about one quarter of the principal – that is comparing the likely loss of savings with the (nominal) annualised interest fee charged by most Indian MFIs.

It is clearly high time that the microfinance industry focused on comprehensive financial inclusion, and ensuring that poor clients do not just get loans (and the risk of over indebtedness), but also access to secure, reasonably priced insurance, remittance and of course, savings services. Only when this occurs can we really claim that we have achieved “financial inclusion”.

In the past few years, *MicroSave* has been working with several organisations across Asia and Africa for fulfilling the objective of delivering market led and efficient savings services to low income clients. *MicroSave* has worked with a variety of organisations including Kenya’s Equity Bank, Tanzania Postal Bank and IFMR Trust, Drishtee, Prayas and Eko in India so as to understand the client requirements and to design or modify the solutions according to the needs of the target clientele. This booklet brings together a set of brief publications which delve into *MicroSave*’s rich sectoral expertise and experience and combines it with the views and opinions of leading practitioners so as to stress on the need for savings services among the underprivileged clients, highlight the opportunities presented for delivery of such services and some challenges encountered in the provision of savings services to the poor. It highlights many of the opportunities, needs, issues and challenges facing those who would provide appropriate, market-led savings services for the poor.

It is divided into three sections:

1. The Demand for Savings Services Amongst the Poor
2. Opportunities and Challenges of Supplying Savings Services to the Poor
3. Regulatory Issues

1. The Demand for Savings Services Amongst the Poor

1.1 *Money Managers: The Poor and Their Savings* – Stuart Rutherford

This note, based on the seminal “The Poor and Their Money” discusses the savings needs of poor people in various stages of their lives. The note categorises poor people’s expenditure into life cycle events, emergencies and opportunities, the needs for which often exceed the amounts saved. The note also suggests three ways to convert the savings into a good lump sum – “saving up” by putting aside a small sum of money till it accumulates into a large sum, “saving down” in which the saver receives an advance against future savings (repayments), and “savings through” where the client continuously saves on a regular basis, and a matching lump sum is made available at some point in time during this flow of savings deposit – for example Rotating Savings and Credit Associations (ROSCAs). The note highlights the need to design products which are convenient, quick, appropriate, flexible and affordable.

1.2 *Developing Security for Low-Income People in Old Age* – Madhurantika Moulick, Graham A.N. Wright, Corrinne Ngurukie, Angela Mutua, Moses Muwanguzi and Michael Onesimo

The number of people aged over 60 in the developing world is predicted to rise from 375 million in 2000 to 1,500 million in 2050. This briefing note outlines the economic and social challenges which come with old age in East Africa. It documents some of the common traditional practices adopted as a security measure against these challenge. It outlines the general saving methods, focusing on educating people on why and how to save. It presents a potential for a long-term contractual savings services which can provide security in old age.

1.3 *Savings Behaviour of Poor People in the North East of India* – Madhurantika Moulick

This note explains the importance of savings services for the clients in the north east region of India, noting that the poor do save, but that they often lose their savings in the absence of any formal source. It reviews the savings mechanisms adopted by the poor some of which, in the case of the formal sector, are not in line with their needs. The poor, therefore, use semi formal systems such as SHGs and MFIs, and informal mechanisms such as savings at home, with NBFCs, ROSCAs, and ASCAs. It suggests four savings products based on various attributes: security, accessibility, returns and other key preferences of low income people.

1.4 *Village Financial Systems in North East India* – Abhijit Sharma and Brett Hudson Mathews

Villagers in lower Assam are pioneers on the frontiers of informal finance, according to the results of recent field work conducted by the Indian Institute of Bank Management and *MicroSave*. This note provides an overview of the village financial systems in north east India, highlighting the security, flexibility and the multiple needs met by these Accumulating Savings and Credit Associations (ASCAs).

2. Opportunities and Challenges of Supplying Savings Services to the Poor

2.1 *Mobilising Savings* –

Graham A.N. Wright and Marguerite Robinson

People save because of many reasons such as insurance against emergency, investment, social obligations, and derive ingenious (often costly) mechanisms to save. This note, thus, focuses on voluntary savings services, as compulsory savings services have been seen to drive client churn and drop-outs in East Africa, Bangladesh and other competitive environments. The note also highlights the obvious fact that, in many cases, people do not want loans to meet their needs – and would prefer voluntary savings services to do so. It further recommends that MFIs conduct market research and feasibility analysis, before introducing savings services. Finally, the note also highlights the complexity of running voluntary savings systems and issues related to costs, Human Resources (HR), Management Information Systems (MIS) and management systems.

2.2 *Two Perspectives on Savings Services* –

Graham A.N. Wright

This note analyses savings from two perspectives: that of the poor, who traditionally prefer “structured and committed savings mechanisms that prohibit them from withdrawing in response to trivial needs and allow them to fend off the demands of marauding relatives requesting ‘loans’ or assistance” and the MFIs, who “tend to use a strategy of ‘permanence and growth’ and look to create sustainable institutions that deliver financial services to an ever-increasing number of clients”.

2.3 *Introducing Savings into a MicroCredit Institution: Lessons from ASA* –

Graham A.N. Wright, Robert Peck Christen and Imran Matin

This note draws lessons on introduction of an open access savings scheme from a successful MFI - ASA (Association for Social Advancement) in Bangladesh. It discusses the organisation’s motivation for introducing the savings product, and then its return to what was essentially the original compulsory savings due to complex management issues arising from the new savings scheme. The note draws conclusions on the significant institutional changes required for the management of voluntary savings systems including information systems, auditing systems, HR/training, organisational culture and understanding clients’ needs.

2.4 *Grameen II: Member Savings* –

Stuart Rutherford

This note addresses the significant growth in new member savings. Some of the most important changes are in the bank’s new approach to savings deposits. Under ‘classic’ Grameen – the products and rules in force up to 2002 – Grameen took mostly obligatory savings from its members and stored them in accounts for individual members and in joint-owned ‘group’ accounts. Under Grameen II, it has introduced greatly expanded deposit opportunities to both members and the general public. By the end of 2004, total deposits (from members and from the public) exceeded the value of loans outstanding for the first time in the bank’s history. This completes the bank’s transition from a ‘microcredit’ bank to a true intermediary.

2.5 *SHGs Should Balance or Break* –

Brett Hudson Matthews and Trivikrama Devi

This note highlights concerns amongst SHG (Self Help Group) members in accumulating too large a balance in their SHGs' internal funds for fear of losing it to unscrupulous leaders or poor lending decisions. The note recommends that to maintain their integrity, SHGs should either balance their accounts, and thus conduct rigorous internal audits, or (taking a practice from most quality ASCAs across the globe) should “break” or dissolve every year or so, in order to check that all the funds are accounted for.

2.6 *Reaching Remote Areas* –

Abhijit Sharma

Assessing the limitations faced by the poor due to lack of financial access, this note highlights the indicators for financial inclusion in the north eastern states of India. It underlines the geographical diversity in the north east, highlighting the fact micro and small enterprises thrive in the region despite being largely dependent on informal sources of financial services. The note also provides an assessment of the growth of microfinance in north east India. It suggests that a start-up and capacity building fund, high quality technical service providers, and building institutional mechanisms for effective interventions, would lead to the better development of the microfinance sector in this region.

3. **Regulatory Issues**

3.1 *The Relative Risks to the Savings of Poor People* –

Leonard Mutesasira and Graham A.N. Wright

This note presents the findings from an extensive qualitative and quantitative study conducted by *MicroSave* in Uganda. The widely-acclaimed study revealed that poor people are lacking access to formal means of savings, and thus face extremely risky environments when they save in the informal sector. For example, the study showed that over 99% of poor people saving in the informal sector lost some of their savings. They lost an average of 22% of the amount they have saved in the last year. Unsurprisingly, people who had access to formal savings services had saved on average three times more in the last twelve months.

3.2 *Savings Services for the Poor: An Old Need and a New Opportunity for Microfinance Institutions in India* –

Sanjeev Kapoor

This note discusses savings as an important and effective strategy for poor households to avoid potential loss of economic status or independence as a result of a crisis. It also provides a rebuttal to the theory that the “poor cannot save” through various examples in India, the most successful of which is the SHG-Bank linkage programme. The note highlights the legal constraints of the present MFIs in accessing savings services from the clients, and efforts by the regulators in India in this direction such as introduction of Banking Correspondents.

3.3 *MFIs as Business Correspondents: To Be or Not to Be?* –

Anup Singh and Krishna Thacker

This note examines the viability of the Business Correspondent (BC) model for MFIs, based on field experiences in India, concluding that it is very difficult for MFIs – either traditional ones or

kiosk-based systems – to make operations viable under the existent regulations. Experience to date suggests that BC operations in its current shape (primarily savings) might be viable only in the longer term. The note makes concrete recommendations on changes required to the regulations covering the BC model in order to make it sustainable and viable for MFIs and other agents to implement – thus promoting financial inclusion in India.

3.4 *Making Business Correspondence Work in India* – Carolina Laureti and Brett Hudson Matthews

This note summarises the findings of a 3-month project by *MicroSave* in India to clarify prospects for a sound business model for Banking Correspondent operators under the current regulations. The study analyses three diverse cases that involve differing institutional arrangements and strategies for sustainability, concluding that achieving profitable operations will remain challenging under the current regulatory environment.

MONEY MANAGERS: THE POOR AND THEIR SAVINGS

Stuart Rutherford



INTRODUCTORY OBSERVATIONS

Before poor people can begin to access opportunities to generate income/employment they need to reduce their *vulnerability* and develop the mechanisms to manage *risks* they face. Essentially, they need to create a stable platform on which to build income generation activities/businesses without falling prey to the crises that so regularly beset poor households. Without this stable platform to allow them to cope with crises, poor households are often forced to use creative money management mechanisms to respond whenever their children fall sick, thieves visit them, animals die etc. Many of these mechanisms (including de-stocking business and diverting loans) have direct impact on the loans that MFIs may have advanced to support their business.

THE MAIN MONEY MANAGEMENT PROBLEM: ASSEMBLING LARGE SUMS OF MONEY

Despite their small incomes, the poor are faced, surprisingly often, with expenditure needs which are large in relation to the sums of money that are immediately available to them. Although day-to-day household expenditure – food is often an example – can be roughly matched with income, there are many other expenditure needs which call for sums of money much larger than they normally have in their purse or pocket.

There are three main categories of such occasions:

- **Life cycle needs.** The poor need usefully large sums of money to deal with life cycle events such as birth, death and marriage, education and home-making, widowhood, old age and death, and the need to leave something behind for one's heirs, and for seasonal variations in consumption.
- **Emergencies.** In order to cope with impersonal emergencies such as floods, cyclones, and fires, and with personal emergencies such as illness, accident, bereavement, desertion and divorce, large sums of money are again required.
- **Opportunities.** As well as needs there are opportunities that require large sums of money, such as starting or running businesses, acquiring productive assets, or buying life enhancing consumer durables such as fans, televisions and refrigerators.

Finding these large lump sums of money is the main money management problem for poor people.

The poor themselves recognise the need to build savings into lump sums and contrary to popular belief, the poor *want* to save and *try* to save, and all poor people except those who are entirely outside the cash economy *can* save something, no matter how small. When poor people do not save it is for lack of opportunity rather than for lack of understanding or of will. The predicament of the poor can be expressed in the phrase “too poor to be able to save much; too poor to do without saving”.

THREE WAYS TO CONVERT SAVINGS TO LUMP SUMS (FROM RUTHERFORD 1999¹)

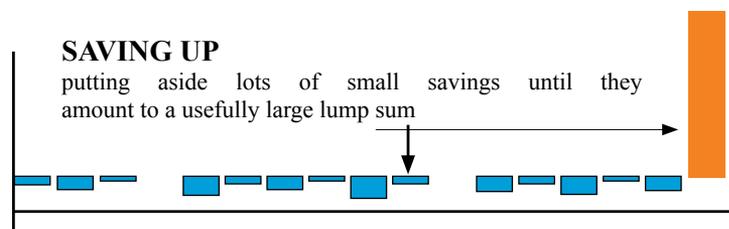
There are several ways in which savings can be built into usefully large sums of money, but they fall into three main classes, as follows:

1. *Saving up*

This is the most obvious way. Savings are accumulated in some safe place until they have grown into a usefully large sum. Many poor people lack a safe and reliable opportunity to save up. As

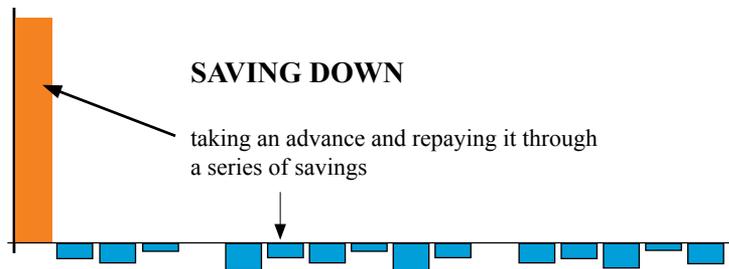
¹ Rutherford, Stuart, “Savings and the Poor: The Methods, Use And Impact Of Savings By The Poor of East Africa”, *MicroSave* 1999 available on *MicroSave's* website: www.MicroSave.org under the Research Papers Section.

a result, they may be willing to accept a negative rate of interest on savings, in order to be able to make deposits safely. We see this in the case of the deposit collectors that work in the slums of Asia and Africa.



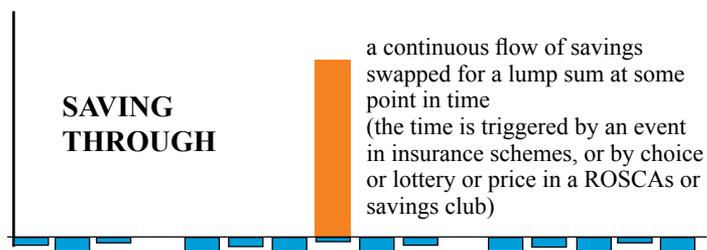
2. *Saving down*

In ‘saving down’, the poor are lucky enough to have somebody give them an advance against future savings. The savings then take the form of loan repayments. Many urban moneylenders offer this service at high cost. MFIs, like Grameen Bank in Bangladesh or PRIDE in East Africa, offer a similar service but do so at a lower cost and with greater reliability. The recipient of a PRIDE or Grameen Bank loan makes a large number of repayments at short intervals and these repayments can be sourced from the borrower’s capacity to save. The advance can therefore be spent on any of the uses in the three classes listed above².



3. *Saving through*

In this third case savings are made on a continuous and regular basis, and a matching lump sum is made available at some point in time during this flow of savings deposits. The services offered by insurance (in which case the savings take the form of premium payments) are of this type, though the poor are very rarely offered formal insurance services. ‘Saving through’ is also offered by many forms of savings clubs, including, notably, rotating savings and credit associations, or ROSCAs. ‘Saving through’ therefore constitutes the most common class of device that the poor are able to provide for themselves.



SO WHAT ARE THE POOR DOING?

The vast majority of poor households are forced (through lack of alternatives) into using a wide variety of mechanisms to save up, down and through in the informal sector. But all of these informal mechanisms, whether ROSCAs, ASCAs, savings, deposit collectors or pawn-brokers are characterised by clubs, indigenous insurance schemes, money guards high risk and high levels of loss. The use of the group guarantee system by MicroFinance Institutions (MFIs) – particularly when high drop-out rates rapidly result in groups of members who scarcely know each other – results in high levels of loss to defaulting members.

² That is, it is not necessary to spend the advance on ‘income generating activities’ that produce an immediate stream of additional income. Of course, the source of the savings that are used to make the repayments may or may not be a business.

The challenge for MFIs is to develop appropriate, secure quality financial services for the poor.

WHAT ARE “QUALITY FINANCIAL SERVICES” FOR THE POOR? (FROM RUTHERFORD 1999)

Financial services for the poor are services that help the poor turn savings into lump sums. Good financial services for the poor are a matter of doing this:

- In as many *different ways* as possible (saving up, saving down and saving through)
- Over as many *different periods* (varying from very short term for quick needs, to very long term for old age or widowhood, for example) as possible.
- In ways that are *convenient, quick, appropriate, flexible and affordable*.

HOW TO DESIGN BETTER FINANCIAL SERVICES PRODUCTS FOR THE POOR

1. accept the **right kind of pay-ins:** (remember, the pay-ins might be savings, repayments, insurance premiums, or contributions to a ROSCA etc.)
 - allow *small* sums to be paid in
 - allow *variable* sums to be paid in
 - allow sums to be paid-in *frequently*
2. allow clients to take out the **right kind of lump sums:**
 - provide a *savings bank service* (saving-up)
 - provide an *advance-against-future-savings* service (saving-down, or loans)
 - allow *short-term, mid-term and long-term* swaps (saving up, down and/or through)
 - place no restrictions on how the lump sum is *used*
3. make it **convenient** to pay-in and take-out
 - allow sums to be paid in and taken out *locally*
 - allow sums to be paid in and taken out *quickly* (on demand and with minimum delay)
 - recognise that clients may accept group formation as a price worth paying for a service but will prefer an *individual service*
 - make the services open to *all poor* people (not just women, or just adults, or just one person per household)

Designing such quality financial services is the challenge for the future of the microfinance industry.

CASH, CHILDREN OR KIND? DEVELOPING SECURITY FOR LOW-INCOME PEOPLE IN OLD AGE IN AFRICA¹

Madhurantika Moulick, Corrinne Ngurukie, Angela Mutua,
Moses Muwanguzi, Michael Onesimo and Graham A.N. Wright



¹ This *MicroSave* Briefing Note was prepared on the basis of the findings of the research conducted. The full paper is available on *MicroSave*'s website: www.MicroSave.org under - Research Papers Section.

INTRODUCTION

The number of people aged over 60 in the developing world is predicted to rise from 375 million in 2000 to 1,500 million in 2050 (Gorman, 2004)². In sub-Saharan Africa the number of people aged 60 and over, will more than double in the next 30 years, despite the impact of HIV/AIDS on life expectancy at birth (Gorman, 2004). Africa's older population will have increased to 204 million by 2050 from the present 42 million (HelpAge, 2005a)³ which will make more than one in ten in sub-Saharan Africa to be over 60 (Gorman, 2004).

CHALLENGES OF OLD AGE

'Old age', a relative concept, has been used in this paper in relation to the regular income earning capacities of people, regardless of age or source of income. Old age comes with some financial challenges. People get used to a regular life style during their productive years, which changes with age as they lose their direct source of income and thus become dependent on previous investments, if any, or on social safety nets.

Economic

Small regular source of cash: For most of the respondents, meeting basic needs of food, shelter and clothing is the biggest challenge in old age. The issue is not the high cost of these consumption needs but that of planning to ensure a small but regular source of cash during old age.

Mismanagement of funds: Those people privileged enough to retire with a pension from a company or the government often receive a lump sum. In many cases, lack of knowledge on investment opportunities or of business acumen leads to the loss of the whole amount within a very short time.

Access to credit: The aged are often willing to shift to some work/business that demands less physical labour. As a result they may want credit to start a business but lack the necessary collateral in the form of assets or savings.

Social

Excess financial costs: The HIV/AIDS pandemic is shifting much of the responsibility for taking care of children to their grandparents - who themselves are often in old age and have meagre income. "... they are faced with the arduous task all over again of raising children and finding money for clothes, food and school and clinic fees" (Hampson, 2005)⁴.

Social Challenges: When people retire their lack of engagement in work makes them feel unwanted, a problem exacerbated by the disintegration of extended family structures, which have left parents and grandparents uncared for.

Preparing for Old Age

MicroSave's study revealed both economic and social issues in relation to preparing for a secure old age. Respondents felt that Africans in general do not consciously plan for their future – there is little or no culture of saving up for future needs. Daily consumption needs take priority even though these are not always restricted to necessity items. Hence money, which could have been saved for the future, is used up.

² Gorman, Mark, "Age and Security", HelpAge International, 2004.

³ Aging in Africa, HelpAge International, Issue 23, 2005a.

⁴ Hampson, Joe, "Threats To Health And Well Being In Africa", Islamset www.islamset.com/healnews/aged/Joe_hampson.html.

The common activities that are taken up, more as traditional practices, rather than as a conscious preparation for old age, are as follows:

Investment in Assets: In simple terms, the common trends in investment may be categorised as follows. Those with

- Small savings commonly invest in small-scale farming (e.g. growing crops and rearing animals)
- Medium sized savings invest in small businesses (e.g. butcheries, trading or rent farms for commercial farming)
- Larger savings invest in plots and build houses for rent, or buy a tractor for work in large wheat farms.

Investment in Children: While school fees constitute a significant part of household expenditure, parents view this as an investment, assuming that children will take care of them in their old age. Depending on the social background, some send their children to school or engage them in vocational education to acquire skills through apprenticeship, while others invest in their children by ensuring they get to university and get good jobs.

Invest in parallel business: Many employed people invest in small agricultural projects or enterprises during their employment years. Their children or other family members run these, until the employed person themselves take over after retirement. Those who can accumulate a lump sum, invest in long-term business such as building schools or rental houses in the towns and cities.

Save Cash in Banks: Saving up in cash in banks is not the most common way to save. Most citizens of East Africa simply do not have enough faith in banks to entrust their long-term savings to them. In addition, banking charges are very high – particularly in Kenya.

Some respondents said that while people save up in banks through savings accounts or fixed deposits, these were more for short-term needs than very long-term requirements.

Informal Groups: Most women respondents (from low and middle income groups) and men (from low income groups) are members of informal financial groups – the “merry go-rounds” or Rotating Savings (and sometimes Credit) Associations. These bodies help them to save up some money that is eventually invested in an income-generating project or to buy small household items.

Only those people who are more informed and better off invest in shares, co-operatives and insurance policies.

METHODS OF SAVING

All the above investments require funds big or small, short term or long term. These amounts are acquired in various ways.

Specific Schemes: With the lack of a strong savings habit and reliable financial system for the low-income people, cash savings come mostly through forced savings in government schemes, welfare schemes in cooperatives. People also join cooperatives to save up to be able to access a loan to help them buy an asset, which will then bring income in their old age.

Cash Savings: Savings in cash are mostly short term, with an aim to pay for some planned or regular consumption need, or to use as a security to take a loan. People usually tend to consume all what is

earned even before the month end. If however they manage to save any small amount, it is saved up in banks and informal groups or with MFIs.

These small cash savings are not directly for long term. They are short-term savings used to buy assets that will help in the long run to earn income or to use as security to get a loan. People find contractual savings very helpful in saving up these small lump sums to use mainly for school fees or for buying household items and electronics in urban areas and working tools or cattle in rural areas. However this kind of product is not yet popular in the region and would require additional promotion. The performance of *Jijenge*, a contractual savings product of Equity Bank in Kenya, reinforces this. It contributes a very small portion to the deposits mobilised by the bank. By contrast, at BURO, Tangail in Bangladesh, the contractual savings agreement product accounts for two thirds of the net savings mobilised.

Save at Home: Due to high banking charges, limited outreach in rural areas and poor past performance of banks in East Africa, most cash savings would be found at home. This kind of saving is again often targeted but for even smaller amounts, such as, buying Christmas gifts. When the target is met, the saving cycle is repeated for another purpose.

DESIGNING A SAVINGS SCHEME FOR OLD AGE

Awareness Generation: The basic need is to educate people on why and how to save. This should be coupled with a savings scheme, such as outlined below:

Savings Scheme: People expressed the need for an affordable savings product with no or limited withdrawal (may be lump sum every 5 or 10 years) for emergencies. Benefits like using the savings as security to access loans, special customer service, support services such as treatment, funeral support, counseling and business (investment) advisory services, and medical insurance cover will be added incentives.

Pension Cum Mortgage Scheme: The amount saved up would be invested to buy property, which would be subdivided into small plots and distributed to the savers. If the investment were in building(s), the bank would continue managing the building(s) and the savers would receive the earnings on a monthly basis. SACCOs that engage in property investments could do this.

CONCLUSION

Demand Side: Currently, low-income people rarely plan for old age as either because they do not feel the need to do so or because available resources are meager. When they do, they use a variety of informal, and often insecure, approaches to meet this goal by investment in kind. A key reason for savings through in-kind investment is the inflation rate of 4 to 9 % in the three East African countries and the devaluation of currencies over the past five years (CIA – The World FactBook). This has increased cost of living and has negative impact on long-term savings, especially which is felt by the poor who save small amounts. Furthermore, most banks in East Africa are over-liquid and the T-bill rates in the region are relatively low (as of May 2005 around 8%) which earns low returns on savings.

The potential market for long-term contractual savings services to provide security in old age is huge and growing over time. The two potential markets are the middle aged who would require income streams during their old age in about 20 years time; and the younger population who are entering the income earning stage and have shown a rising consciousness about the need for saving for old age.

Supply Side: Banks in East Africa are presently cash rich and hence a long term high interest savings product may not be what many financial institutions would want to promote. Nonetheless, such long term savings instruments for the low-income market may be attractive products for savings banks to offer. Alternatively, it may be more desirable, for both the banks and their customers, to offer short and medium term contractual savings products. Customers could then use the lump sums generated through these products to buy the land, housing etc. they hope will provide the security in old age.

Institutions offering this product need to be exceptionally stable, have excellent asset-liability management and require careful selling and well-calculated investment plans.

SAVINGS BEHAVIOUR OF POOR PEOPLE IN THE NORTH EAST OF INDIA

Madhurantika Moulick



The scenario is grim when available options for savings - the “forgotten half” of financial services – are studied in the context of yet another forgotten area the North East Region of India (the NER). The findings of recent *MicroSave* research reinforce that: everyone saves; that low income people in remote areas also save; and that they save significant amounts, of which much is unfortunately lost to fraudulent operators in the absence of a secured and accessible savings services.

Savings in the NER is practised through informal, semi-formal or formal mechanisms in the form of cash, in-kind or account based savings. The choice is mostly influenced by the economic status of the user. Respondents categorised users as poor, not so poor and rich, based on the local perceptions of economic status, which is usually related to stable cash flows, asset base (land holdings, livestock, jewellery) and availability of lump sum amounts to cope with crises.

Savings in cash at home has the advantage of liquidity and accessibility, but as it is vulnerable to theft or being frittered away, it is not the preferred mechanism. *Savings in-kind* is common because it provides quick and higher returns, for example through the reproduction of livestock. It is also used because of traditional social practices and the status attached to assets like land and jewellery. Nonetheless, savings in kind is highest amongst low income people, usually not by choice, but for want of a better option. Saving with Non Banking Financial Companies (NBFCs), Rotating Savings and Credit Association (ROSCAs)¹ and Accumulating Savings and Credit Associations (ASCAs)² is a more common practice, due to their high outreach and simple processes. Despite major concerns about their security amongst almost all respondents - most of whom have lost money many times - saving through these informal systems continues.

Although most people would prefer to save in a secure and accessible account in a formal institution, there are formidable barriers. Such institutions can be located at a long distance from many of the villages in the hilly parts of the region. The products offered often do not meet clients’ needs effectively, and they are delivered by staff members who are not sensitive to the needs and expectations of low income people. Government led initiatives, like the ‘no frills’ account, have been introduced, but these are not promoted aggressively – presumably because of the cost implications for the banks.

The above advantages and disadvantages of each mechanism affect the choice of savings options by different economic category of rich, not-so-poor and poor. Understandably, the rich are the highest users of the formal institutions and the poor the lowest. Semi-formal institutions such as Self Help Groups (SHGs) and Micro Finance Institutions (MFIs) cater more to the poor and reach out to the lower segment of not-so-poor category. Multiple informal mechanisms are used in parallel, mostly by the not-so-poor category, as these mechanisms diversify the poor’s risks and help them accumulate lump sums to meet some planned need or to invest in some asset. The poor also often use the informal mechanisms, but the most commonly used option is simply to hold cash savings at home, which is mostly driven by lack of feasible alternatives.

¹ ROSCAs (Rotating Savings and Credit Associations, known as Marups in Manipur) are groups of people who pool money weekly or monthly and then distribute it to the RoSCA members in turn. The turns are decided by mutual consent, lottery, seniority within the group or bidding. The frequency of deposit in the pool depends on the occupation of members, and members all typically save the same amount (although some members may have multiple ‘shares’ and thus contribute double or triple the amount and thus receive two or three pay-outs). The tenure depends on the number of members in the group and typically varies from 20 to 30. No new memberships are allowed during the tenure, and the group dissolves after the tenure.

² ASCAs (Accumulating Savings and Credit Associations), also known as Sonchay, Somobay, Samiti, Got (in Assam): These are savings based groups of generally 25-40 where members deposit monthly savings of a fixed amount into a central pool, from which money is lent out to members and non-members. ASCAs are usually purpose-based groups which run for 1-2 years, and often liquidate and provide payouts prior to festivals. Members earn interest in proportion to their savings amount. ASCAs are very common in the valleys of Assam, as well as in some parts of Meghalaya and Nagaland

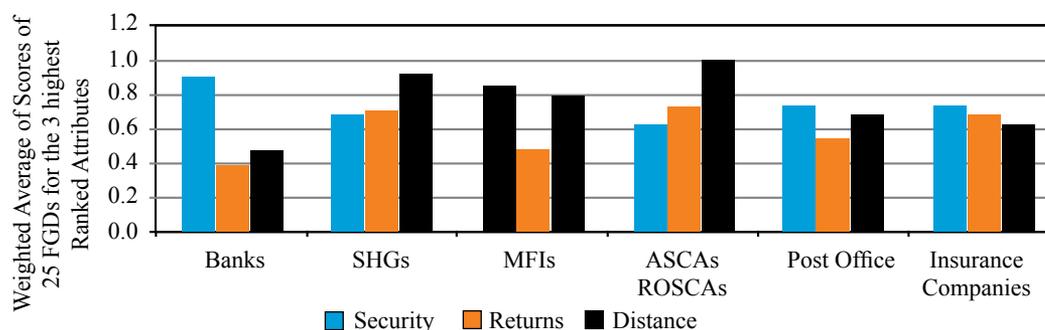
Lack of access to formal financial institutions has resulted in the emergence of a variety of informal systems based on socio-economic structures and needs. The informal mechanisms prevalent in the North East need special mention. On one side, there are the savings mobilisation initiatives to support the lowest income section and for emergencies like natural disasters, death in the family through:

- *Namghars* and *Pujaghars* which are prevalent in Assam. A compulsory deposit of a fixed amount by each household is made to the *Namghar* (prayer hall) in a religious institution. It is lent out at zero or lower than market interest rates to address emergencies or extreme distress. Some amount is also used for common community needs, such as road construction.
- *Shinglups* which are prevalent in the Manipuri community of the valley region of Manipur. They are religious boards in each locality which take care of the expenditures incurred during death ceremonies.
- *Mahari Associations* which are welfare groups prevalent amongst the Garo clan in Meghalaya. Contributions are made by all households of the clan, the amount being fixed by the committee, headed by the *Nokma* (the village headman). *Mahari* fund is used for the general welfare of the clan, for marriages, death ceremonies, emergencies, etc.

On the other hand, there are mechanisms focused on economic gains, and these include the *Samities* (ASCAs) which are focused primarily on savings (but with access to emergency loans from the central fund) or the *Marups* (ROSCAs) which is a source for both savings and credit.

The four products that emerged from this research are based on these various factors and are supported by the preferences of low income people. Within these preferences, the attribute of security of savings ranks the highest, as it is a precondition for a product or a delivery channel to be broadly acceptable in the first place. Similarly, the *distance or accessibility* to services is also considered most important – for without access, the savings service is useless. As options for any financial services are limited, leveraging savings for loans or getting *high returns* on savings is in demand, but less essential.

RELATIVE PREFERENCE FOR SAVINGS MECHANISM



As shown in the graph, different delivery channels are preferred to meet these attributes of security, accessibility and returns. Thus while banks are preferred for security, SHGs and ROSCAs are preferred for accessibility. SHGs and ROSCAs along with insurance companies are preferred for high returns for short term and long term savings plan respectively.

Four products were designed on the basis of the study:

General Savings Account: Simple demand savings account that encourages people to enter the formal financial system. It welcomes and helps people develop a relation with a secured financial institution.

Short Term Recurring Deposit Account: Helps save up small lump sums to address a variety of small and often recurring client savings needs or to achieve small dreams.

Long term Recurring Deposit Account: Aimed to help strengthen coping capacities significantly by savings up for planned expenses and reducing dependence on loans.

Monthly/Annual Fixed Deposit with Certificate Account: Simple, flexible fixed deposit product that captures seasonal cash surpluses for future use.

VILLAGE FINANCIAL SYSTEMS IN NORTHEAST INDIA

Abhijit Sharma and Brett Hudson Matthews



Villagers in Lower Assam are pioneers on the frontiers of informal finance, according to the results of recent field work conducted by the Indian Institute of Bank Management (Guwahati) in collaboration

A Tale of Two Villages

	<i>Mazarpara</i>	<i>Khakhrisal</i>
Households	72	130
ASCAs	26	20
Memberships	524	493
Memberships/household	7.3	3.8
Bank/post accounts	6	1
Value of village system	\$16,117	\$13,051

with *MicroSave*, in two local villages (Mazarpara and Khakhrisal). The villages boast 46 ASCAs (referred to locally as *xonchoi samities*) varying from 6 to 65 members (see data snapshot).

With about Rs.1.45 million (US\$29,168) in these villages' ASCA systems, average member balances appear small (about US\$35). But there are 1,017 discrete ASCA memberships distributed among

the villages' 202 households – an average of 5 per household. This puts average household balances at around US\$145 - a significant sum. Loan rates are typically about 3-5% a month, with some ASCAs lending to non-members at higher rates.

Of the two villages, Mazarpara is more urban and more economically active. Villagers say there are far fewer moneylenders now than in the early 1980s, when the first ASCAs started. There is a commercial bank in Chaygaon where 5 ASCAs hold liquidity or savings accounts. But individual villagers rarely use it because of its high deposit requirements and fees, combined with the villagers' low levels of literacy. Confidence in the ASCAs may be another reason: villagers state that no ASCA has failed in the history of the village.

A Financial System is Flexible ...

To accommodate more affluent households, ASCAs permit members to take shares in multiples of the base rate. Thus if the standard contribution is Rs.50 a month, an affluent household might subscribe to 3 shares at Rs.150 a month.

And to address the seasonality of rural cashflows, ASCAs in the more rural community of Khakhrisal adopt several measures:

- They start operations during surplus seasons, (55% of the sample started during the surplus months of January-April, compared to only 16% during the lean months of May-August);
- They take 'top-up' contributions, often of Rs.100 per share, during start-up;
- They permit members to defer contributions during the lean season by converting the amount into short-term loans of up to 2 months; and
- They are much stricter in collections of principal and interest at the end of the cycle (usually another surplus season) rather than the middle.

One *xonchoi* manager explained that "our financial year ends on the 1st of Magh¹ (mid-January). All of our calculations are done then. People find it easier to repay because of the surpluses in their houses".

And Meets Multiple Needs ...

It is generally believed that the informal market, whatever its scale, cannot offer a wide scope of financial services. In Mazarpara, when there is need for a new financial service, the villagers start a new

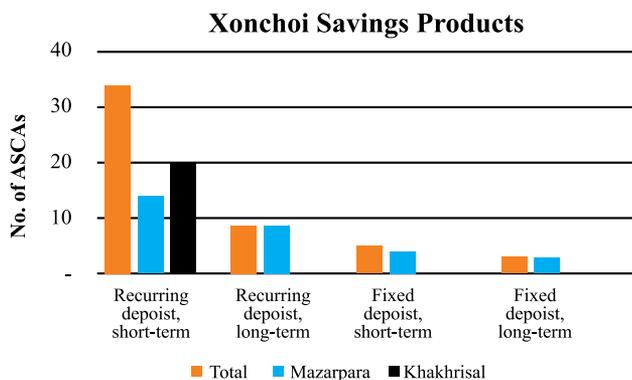
¹ Magh is the Assamese month which begins in mid-January and ends in mid-February.

ASCA. By starting a new ASCA instead of adding the service to an existing one, they keep the risk of loss in any individual ASCA manageably small.

The following types of ASCAs operate in Mazarpara:

- The classic ‘recurring deposit’ ASCAs provide members with lump sums dedicated to a specific savings purpose, like a festival, a wedding or school fees.
- A ‘retirement ASCA’ with 65 members is nearing the end of its 4th 5 year cycle. It invests all savings in a recurring deposit at the nearby Post Office.
- Several ‘term deposit ASCAs’ were formed by members who pool cash surpluses they do not need in a one-time deposit. These ASCAs may last for 2-5 years and to avoid book-keeping complications do not accept subsequent deposits.

Average effective profits per member were 21.3% in Mazarpara and 58.3% in Khakhrisal, calculated on the basis that the groups broke and disbursed all assets the day of the survey. The wide divergence results from sharp differences between urban and rural settings and ASCA strategies.



In Mazarpara ASCAs charge lower rates (typically about 3% a month) and less than 53% of their assets were invested in loans, while the balance was in bank and post office accounts. In Khakhrisal by contrast, ASCAs charge higher interest rates (typically about 5% a month) and over 99% of their assets were invested in loans the day of the survey.

... and Exercises Collective Control

Xonchoi Financial systems Compared

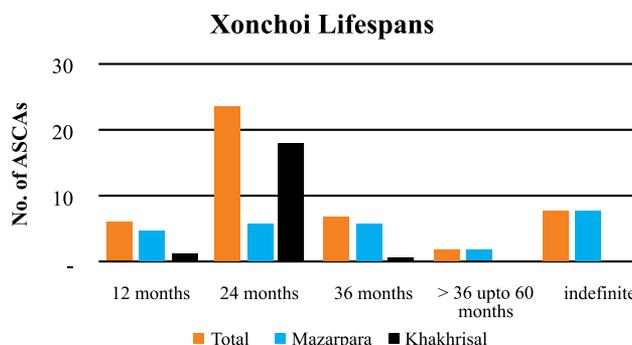
	Mazarpara		Khakhrisal	
	Nov. 18-20, 2008		Feb. 14-15, 2009	
	US\$	%	US \$	%
Assets				
Cash in hand	3,860	24%	46	0.4%
Cash in bank	1,929	12%	-	0.0%
Term deposit in bank	1,657	10%	42	0.3%
Term deposit in post office	201	1%	-	0.0%
Loans outstanding	8,470	53%	12,964	99%
Total	\$16,118	100%	\$13,051	100%
Liabilities and Equity				
Savings/equity contributions	10,609	66%	9,652	74%
Retained earnings	5,509	34%	3,398	26%
Total	\$16,118	100%	\$13,050	100%

In Mazarpara there is an active para-profession of 6 xonchoi auditors, usually school teachers or educated village youth, in addition to four or five others who are sometimes called upon to undertake the job. These auditors have a vested interest in auditing the books thoroughly as most of them are also group members who own multiple shares.

Some groups assign different members to maintain assets and

liability records, which are reconciled quarterly.

Rutherford has aptly described ASCA dissolution as an ‘action audit’, since it answers every member’s silent and continuous question: “Is my money safe?”² But if dissolution is a highly effective form of informal audit, why are actual auditors needed and valued in these villages?



1. These ‘frontier’ ASCAs are unusually long, up to 5 years and in eight cases, indefinite. The village auditors check the books annually – effectively replacing the action audit with a more technical audit.
2. Audits are conducted immediately before dissolution, which introduces an independent check against the risk that the members may not catch an error or fraud at the end of the cycle.

In addition, there appears to be a relationship between linkage to formal sector financial services and ASCA longevity. For the small sample studied, the correlation between ASCA longevity and institutional linkage was +0.653, with confidence of greater than 99%. In other words, if an ASCA is linked to a formal institution the probability of it extending its term is much higher than otherwise. All of these linkages are savings related.

CONCLUSIONS

Globally, ASCAs generally operate within the range of 6-12 months. In the villages studied, none operated for less than 12 months. There were 8 indefinite *xonchois* ranging from 36 to 130 months old. None of these had identified a specific breaking date.

What drives the relative strength of ASCAs in these two villages? This is not yet clear and will require further research. The Mazarpara financial system has received large injections of SGSY subsidies in recent years. Poor repayments in some SHGs have made ASCAs cautious about lending – a factor that may have influenced the emergence of many savings-links with the formal sector.

What seems certain is that in these villages, everybody knows who the good ASCA leaders are, who the good members are, and who the good book-keepers are. In Mazarpara informal audit practices are such that they also know which auditors to trust. Setting up a new ASCA involves little more than identifying reliable members with a shared financial services need. The line separating this complex mix of informal shared understandings and practices from a ‘permanent institution’ appears thin.

² Rutherford, Stuart, “The Poor and Their Money”, Oxford University Press, Delhi, 2000.

MOBILISING SAVINGS¹

Marguerite Robinson and Graham A. N. Wright



¹The first version of this paper was presented at the Conference on Challenges to Microfinance Commercialisation sponsored by the MicroFinance Network and ACCION International in Washington, D.C., June 4-6, 2001.

INTRODUCTION

Throughout time, all around the world, households have saved as insurance against emergencies, for religious and social obligations, for investment and for future consumption. The importance the poor attach to savings is also demonstrated by the many ingenious (but often costly) ways they find to save (Rutherford 1999). But for a variety of reasons, most informal mechanisms fail to meet the needs of the poor in a convenient, cost-effective and secure manner. As a consequence, when poor households' are provided a safe, easily accessible opportunity to save, their commitment to saving, and the amounts they manage to save, are remarkable.

Savings have risen to the top of the microfinance community's agenda. Previously microfinance institutions (MFIs) viewed savings as the poor relation -- Vogel's (1984) "forgotten half" - and typically extracted savings from clients through compulsory systems. There was a prevalent and powerful perception that "the poor cannot save", thus compulsory savings systems often required members to deposit small token amounts each week and levied more substantial amounts at source from loans. These compulsory savings were then often "locked-in" until members left the organisation. Compulsory savings generate a loan guarantee fund for the MFI, but drive up the effective cost of loans. By contrast, voluntary savings are a service from which clients can withdraw and (often but not always) on which they receive interest. This note focuses on voluntary savings services.

A substantial proportion of client exit from microfinance institutions is driven by the credit-only focus of these institutions. For example, in Bangladesh clients drop out in order to (1) collect the funds from their compulsory savings accounts, (2) to access microfinancial services where their savings are available in an emergency, (3) to access enhanced services from other MFIs, i.e. ones that offer a wider range of products. East African microfinance customers also drop out to collect the funds from their compulsory savings account (Wright, 2001).

Microfinance institutions can avoid some client exit by mobilising savings from the public which can be collected profitably on a large scale. Poor people need savings services because of emergencies, opportunities (which are often unexpected), to pay for lifecycle events associated with death or marriage, and to smooth payments of their consumption needs. People do not need loans all of the time, but they do need savings all of the time. (*MicroSave's* "Market Research for MicroFinance Toolkit" can help MFIs research and understand these issues).

SAVINGS AS A SERVICE AND A SOURCE OF FUNDS FOR LOANS

To offer credit services, the microfinance institution selects borrowers that it trusts through business assessments, character assessments, cash flow analysis, or a combination of several tools. In savings mobilisation, however, it is the customer who must trust the MFI (Robinson, 1995).

To begin the process of introducing savings services, the MFI must always conduct market research and feasibility analyses. Once these tests are completed, the institution uses the information to design appropriate high-quality services, which are then tested in pilot projects (see *MicroSave's* "Toolkit for Planning, Implementing and Monitoring Pilot-Tests"). The institution should publicise its instruments and services in locally appropriate ways.

Compulsory and voluntary savings are usually incompatible. However, some institutions have designed programs where a percentage or a value amount of savings are made available to customers, but once customers are allowed to remove part of their savings, they usually prefer complete voluntary savings mobilisation. Quality voluntary savings services will usually mobilise more than locked-in savings.

SAVINGS PRODUCTS

What is most important is not any particular savings product, but the combination of products available from the MFI, which each saver can customise for his or her particular needs. For large-scale savings mobilisation to be viable and to finance substantial portfolios, savings must be mobilised from the public and not from the poor alone. This makes it possible to serve large numbers of small savers profitably. While the transaction costs of very small accounts make mobilising savings from the poor expensive, the larger account sizes of the non-poor raise the average account size and permit a combination of institutional profitability and wide outreach. This cross-subsidisation is the only way that the poor can be served cost-effectively on a large scale. However, such practice requires special attention to ensure that the products are attractive to all potential savers.

COST ISSUES

Contrary to popular opinion, mass savings mobilisation from the public need not be an expensive source of capital. Small savings, when captured as part of savings mobilisation, can be collected at relatively low financial costs. In addition, there are synergies created through the economies of scope between savings and lending.

Products' interest rates and fees can also be used to provide:

- Incentives to build up and maintain balances
- Disincentives to withdraw
- Revenue from transactions/ledger fees

Information costs and loan loss provisions are expected to be less when MFIs can draw on the deposit histories of potential borrowers to analyse their capacity to pay and creditworthiness. It is essential that MFIs cost their products to make informed pricing decisions. Costs of new products are difficult to determine in advance, so pilot-tests are needed to estimate cost accurately. Interest and fees charged should be carefully structured to give clients a choice between products with different ratios of liquidity and returns.

SOME BASIC PRINCIPLES FOR MFIs IN LARGE-SCALE SAVINGS MOBILISATION

Profitable large-scale savings mobilisation is not a matter of adding a few products to a microcredit institution. It changes the institution fundamentally. MFIs should offer only a few carefully designed savings (and other) products. Too many products make branch management too complex and expensive and many products are not necessary for most clients.

- Large-scale savings mobilisation should be limited, except in highly unusual cases, to publicly regulated and supervised institutions that are legally permitted to mobilise public savings.
- Microcredit institutions introducing voluntary savings should pay particular attention to the preconditions required and to appropriate sequencing in terms of research, product development, pilot-testing and roll-out.
- Products are necessary but not sufficient for profitable voluntary savings mobilisation from the public, as they are only one element in a much larger set of requirements (including MIS, training, marketing etc.) for the profitable large-scale mobilisation of savings.

MANAGEMENT, ORGANISATION AND HUMAN RESOURCES

High quality, experienced, and committed governance and management are essential. The MFI should stop efforts to raise voluntary savings if these are not available. Management and staff training and incentives related to each step of the sequencing process are essential. Some managers and staff (especially middle managers) may object to, and in some cases refuse to implement, the necessary

broad-based changes. This problem, where it arises, must be carefully and quickly dealt with (usually not easy). Because mobilising voluntary savings from the public will change the institution dramatically, management, organisation, internal supervision, liquidity management, and financial intermediation are likely to need fundamental restructuring.

WHO BENEFITS FROM MFIs THAT OFFER VOLUNTARY SAVINGS MOBILISATION TO THE PUBLIC?

Clients benefit from savings services, since they need and demand the service. However, the MFI benefits too, for several reasons. First, clients are likely to be more satisfied and therefore more likely to repay their loans to maintain on-going access to the package of financial services. Second, savings provides microfinance institutions with an attractive source of capital: locally mobilised voluntary savings is potentially the largest and the most immediately available source of finance for many microcredit institutions. Small voluntary savings can result in large amounts of funds that are more stable than other funding sources. Third, the MFI receives additional income from loans made, investment of the new capital, and also from fees charged on savings transactions. The national economy also benefits as savings are brought out of the informal into the formal sector and made available for reinvestment.

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TWO PERSPECTIVES ON SAVINGS SERVICES

Graham A.N. Wright¹



¹ Wright, Graham A.N., “A Critical Review of Savings Services in Africa and Elsewhere”, *MicroSave 2000* and Fiebig, Micheal et al. “Savings in the Context of Microfinance – State of Knowledge” in Hannig Alfred and Sylvia Wisniwski (Eds), “Challenges of Microsavings Mobilisation – Concepts and Views from the Field”, GTZ 1999.

SAVINGS PRODUCTS AND SERVICES FROM A SAVER'S PERSPECTIVE

Balancing Convenience, Risk and Returns

It is clear that most poor people do not have access to formal sector banks for reasons that include the:

1. Geographic distance from the financial institution;
2. Terms and conditions governing the available financial services it offers;
3. Disrespectful manner in which the staff treat poor clients;
4. Intimidating appearance of the financial institution; and
5. Complexity of the paper work and the difficult process necessary to make a transaction.

The poor look for some system to provide the security and accessibility necessary to save. Acceptable degrees of security are relative, dependent on the available programme, and are never 100 per cent. Almost every poor person has been in, or knows of, a failed Rotating Savings and Credit Association [ROSCAs] or crooked deposit collector, but the accessibility of a regular opportunity to save in a disciplined manner is what makes ROSCAs and deposit collectors so popular worldwide.

Access is markedly different from **liquidity**, and often considered more important by poor people who have little time to make their transactions. While many authors have stressed that “liquidity is the key to local savings mobilisation”, it is important to note that in many circumstances the poor have a strong “illiquidity preference”. This “illiquidity preference” is in response to the poor’s self-imposed need for structured and committed savings mechanisms that prohibit them from withdrawing in response to trivial needs and allow them to fend off the demands of marauding relatives requesting “loans” or assistance.

With the exception of successful Accumulating Savings and Credit Associations (ASCAs) and auction ROSCAs, the **return** on savings in the informal sector is rarely above zero. Often the poor pay to save through a conveniently accessible system such a deposit collector who visits daily to collect savings.

Managing Liquidity and Duration: A Spectrum of Needs. All families require funds for different purposes that vary with respect to the amount that is needed and the immediacy with which the funds must be made available.

Many emergencies or opportunities necessitate instant access to cash. This explains why almost all poor families keep some amount of emergency savings in the home, and why many do prefer highly liquid savings services. The “illiquidity preference” described above means that poor people have needs that require both liquid and illiquid services and those that save, often hold multiple accounts to do so. Similarly, poor people often use a strategy of “targeted savings”, including some highly illiquid savings, (notably, in the absence of alternatives, MFIs’ compulsory savings) to build-up large lump sums of money to purchase significant capital assets such as land and houses.

Compulsory, Locked-In Savings

The poor require little compulsion to save. They simply want a reasonable mechanism to do so and the assurance that they will be able to access those savings as needed. Indeed, there is evidence that compulsory savings, particularly those that are deducted from the loans issued, are simply viewed by clients as part of the cost of the credit. Some clients use these compulsory savings systems to build up useful, long-term lump sums of money. However, it is possible that well designed open access savings accounts and contractual savings agreement schemes could give clients the *option* of setting these funds aside. Furthermore, such systems would not force the clients to leave the MFI, or reduce their ability to access loans, if they need to liquidate their savings.

DESIGNING SAVINGS PRODUCTS AND SERVICES FROM AN MFI'S PERSPECTIVE

Balancing Convenience and Returns

As seen above, when deciding on savings services, poor people look for a mix of accessibility, security, liquidity and (ideally but not crucially) returns. The financial institution's perspective is almost the mirror opposite of that of the client. Financial institutions would like to maintain a few branches in densely populated areas to maximise the number of clients per branch and facilitate branch security. They would prefer to limit opening hours to allow the opportunity to keep up with the complex accounting and internal control procedures necessary to run a financial institution effectively, and to facilitate physical security arrangements. They would like to see large deposits made for as long as possible with a minimum of withdrawals so that the transaction and liquidity management costs are kept to a minimum and the funds available for on-lending are maximised. And of course, the profit-maximising goal of a financial institution encourages the payment of as little interest as possible. Nonetheless, there are many MFIs that offer micro-savings services on a profitable basis.

Managing the Costs of Small Savings Accounts

One of the chief fears voiced by MFIs revolves around the potential difficulties involved in dealing with the many small transactions often associated with the providing savings services to the poor. While this is indeed likely to be the case, several **important observations** should be made:

1. Generally, the majority of the transactions will be deposits. Indeed the poor are often remarkably unwilling to make withdrawals. However, they do want to know that they could withdraw if a pressing need arose;
2. Poor people have a multiplicity of needs and are not always looking for a highly liquid account to use on a regular basis; and
3. Savings accounts targeted for medium and long-term needs are particularly attractive to MFIs in search of capital for on-lending, and appropriately designed products can encourage these.

There are also important and often over looked, additional benefits of offering savings services to the poor. In addition to providing capital for on-lending, savings services can:

1. Develop the client base (of borrowers) for the future;
2. Obtain information on the clients' abilities to save and (by implication) repay loans;
3. Facilitate repayments when clients are unable to meet repayments out of current income; and
4. Encourage repayments, as clients want to maintain a good reputation and their access to future services.

There are also many ways of **minimising the costs** of providing savings services, and possibly even deriving a profit from doing so. This can be done directly through carefully structured pricing to encourage savers to maximise deposits and minimise withdrawals. MFIs can elect to pay interest only on accounts with balances above a certain minimum. In view of the clear evidence that poor people are willing to pay for convenient savings services MFIs can charge fees for specific savings services. In order to reduce withdrawals, MFIs could limit the number of withdrawals per period, set minimum withdrawal amounts, require notice to withdraw or charge for withdrawals made.

In addition to the pricing structure, the MFI can reduce costs through its organisational approaches and work methods. Finally, it is important that MFIs offering savings services seek up-market, higher-value savers to spread the costs and make the service cost-effective to run.

SYNTHESIS AND CONCLUSIONS

Two different strategies are pursued by outside agencies (be they development or private sector) and by poor people themselves as they seek to design and deliver financial services. The former tend to use a strategy of “permanence and growth” and look to create sustainable institutions that deliver financial services to an ever-increasing number of clients – such as MFIs, banks, and co-operatives. By contrast, poor people generally use a strategy of “replication and multiplication” and look to create many small self-contained, often self-liquidating, schemes – such as ROSCAs and Christmas clubs.

Permanence and growth institutions tend to encourage the long-term build-up of funds through relatively slow, but steady, saving, and are therefore extremely well suited for addressing longer-term savings needs. Replication and multiplication schemes tend to encourage the rapid accumulation and disbursement of funds and are therefore better suited to meeting shorter-term savings needs. There is increasing evidence that providing client-responsive financial services can both serve the needs of poor people while maintaining or in fact improving the sustainability and profitability of the MFIs.

There are no magic formulas for designing appropriate savings products for poor people: it requires market research and careful, systematic product development. But the rewards for the MFIs that undertake these exercises in terms of profits and client loyalty can be remarkable, and well worth the investment.

THE CONDITIONS UNDER WHICH POOR PEOPLE SAVE

From Rutherford², 1996

1. they feel their savings are *secure*
2. they feel they can get *access* to their savings (as withdrawals or as loans)
3. they have the opportunity to save *often and easily*
4. they see the *example* of others saving regularly
5. they feel under some *social pressure* to save
6. they feel they *own* their savings (the savings are not owned by a group)
7. they feel the savings are *growing* (by interest rates or bonuses) and protected from *inflation*

² Rutherford, Stuart “A Critical Typology of Financial Services for the Poor”, Action Aid and Oxfam, London 1996.

INTRODUCING SAVINGS INTO A MICRO CREDIT INSTITUTION – LESSONS FROM ASA

Graham A.N. Wright, Robert Peck Christen and Imran Matin



ASA – A REMARKABLE INSTITUTION

The Association for Social Advancement (ASA) in Bangladesh provides financial services to 1.5 million poor people, and is one of the best-managed, large-scale, sustainable, microfinance providers anywhere in the world. ASA operated a credit delivery and recovery system based on a modified version of the Grameen Bank’s group-based lending methodology, stripped down to an elegantly simple (if somewhat inflexible) system that allowed management to control the flow of money precisely and exactly. Loan sizes and disbursement schedules were standardised and only compulsory savings were collected.

INTRODUCING SAVINGS SERVICES

ASA took the decision to introduce more open access savings services, on the basis that providing high quality savings services was seen as providing a way to access relatively cheap capital, increase outreach, increase lending, maintain portfolio quality, increase productivity, and reduce poverty and vulnerability”. This perception is common amongst MFIs today.

ASA was clear that it did not have the legal mandate to collect savings from non-members beyond those people with direct (usually family) links to its existing clients, and thus it was constrained in any attempts to mass mobilisation of deposits. Given the availability of cheap capital (5% - 7.5% pa) from the Palli Karma Shahayak Foundation (PKSF), ASA did not want to mobilise more, relatively costly, deposit-based capital than it could usefully use in tandem with PKSF’s less expensive capital funds.

THE REVISED SAVINGS SCHEMES

In July 1997, ASA introduced a new open access savings scheme that allowed members access to:

- Their “general account” savings, subject to maintaining 10% of their current loan principle.
- Truly open access accounts through the “associate members’ account.”
- A “long term savings account,” a 5-year contractual savings agreement with monthly contributions ranging from \$2-10.

However, just six months after introducing the open access savings system, ASA had generated \$0.4 million less capital than would have been available under the compulsory, locked-in savings system. Furthermore, much of the balance was highly liquid in nature and subject to immediate withdrawal, thus necessitating ASA maintaining substantial reserves. By the end of 1999, the increases in both deposits and withdrawals meant that the actual net savings balance was only 95% of what it would have been theoretically under the compulsory, locked-in system. Clearly, mass savings mobilisation was not taking place. ASA had simply provided an improved client service at the cost of a substantially increased number of accounts and transactions, without any material increase in the capital generated. Although it might have been desirable to continue the experiment another year, with the uncertainty surrounding the availability of PKSF funds in 2000, the ever growing demand for capital and an eye on the all important bottom-line, ASA needed to make changes.

As a result, the new “composite” savings product was designed and introduced as of November 1999. This “composite” product locked-in 10% of the principle of current loans as of November 1999, plus a compulsory Tk.10 (\$0.20) per week. Any additional money saved on top of the Tk.10 (\$0.20) compulsory amount was fully liquid and subject to withdrawal on demand. Most ASA members were motivated to save at least Tk.20 (\$0.40) per week as a norm. Thus, ASA created an account that met both clients’ needs for an illiquid contractual savings account and a liquid account that allowed them to respond to emergencies, and, at the same time, created the locked-in balances that ASA needed to meet its demand for capital.

However, this system provided ASA's field staff with a complex set of calculations to determine the amount available for withdrawal whenever a client wanted to take out some of her savings. By the middle of 2000, ASA had decided to return to a simple requirement of 15% per current loan in compulsory savings accounts (for the 2nd and subsequent loan cycles) for all members. Thus, ASA essentially returned to its original policies.

FINANCIAL IMPLICATIONS OF SAVINGS MOBILISATION

Many feel that capturing deposits from small clients is too costly and does not represent an attractive funding alternative. Others believe that the industry must offer small depositors an option for managing their liquidity, and that tiny savings accounts not only represent an important financial service for the poor, but potentially, an important source of funds for MFIs.

The full cost of savings mobilisation for ASA amounts to 8.6% of average deposits for 1999, and 2.6% of average 1999 total assets. If this is added to the financial costs of deposits (4.3%), it is apparent that the total savings strategy (including the compulsory savings system that is an integral part of the loan methodology) costs ASA 12.9% of the funds it mobilises. The marginal cost of the savings strategy is about 10.5%. This makes savings as, or more expensive to ASA as borrowing in the commercial sector. ASA currently borrows from Agrani bank at around 9.5%. It certainly costs ASA far more to mobilise savings than it does to access PKSF money.

DISCUSSION AND CONCLUSIONS

ASA's experience provides some very important lessons for the microfinance industry.

- Moving from a compulsory, locked-in savings system, to a voluntary open access savings service, requires significant institutional changes with respect to the management and information systems, auditing systems and personnel/training, as well as to the way units (branches) are furnished and secured, and the very organisational culture. And, of course, it requires the mandate to mobilise savings.
- Open access savings services necessitate highly flexible systems, capable of dealing with numerous, diverse transactions, and are thus not amenable to the rigid systems run by ASA and most microcredit organisations. Open access savings systems with their unpredictable cash flows, necessitate a different type and complexity of control built on a clear segregation of duties, as well as extremely efficient and transparent management information systems.
- The transition from forced to voluntary savings services is not only about the institutional supply side challenges, but also about effecting profound changes in the attitudes and behaviour of staff. To paraphrase Marguerite Robinson, "When lending, the institution must trust the clients - when mobilising savings, clients must trust the institution".
- Locked-in savings can be a source of capital for the institution, but in the long term, such locked-in arrangements can create default and drop-out incentives. Moving from compulsory to voluntary savings products can also lead to a high degree of "cannibalisation" (where one product simply takes over from another, with no net increase in the overall savings balances) – particularly in saturated markets.
- In Bangladesh, individuals within the MFI "target group" are already being given one and often multiple loans. Most clients' cash income is already encumbered by loan commitments and compulsory savings requirements, and thus, the potential for mobilising savings from this group may be limited.

- Microcredit organisations seeking to start mass savings mobilisation also need to overcome the information and knowledge gap within their own organisation. Simply because ASA is an outstanding loan service provider does not inherently make it ready to mobilise voluntary, open access savings. The markets are very different in nature.
- Most microcredit organisations have very limited knowledge of the clients outside their current “target group.” This knowledge must be acquired, if they are to have a reasonable chance of designing, marketing and delivering savings products that are appropriate to the “non target group” market segments.
- Mass savings mobilisation depends on MFIs diversifying their client base by understanding and responding to the needs of people from a much broader range of socio-economic strata than they typically serve with their micro-loan products. In many Bangladeshi villages, for example, remittances from relatives working abroad are likely a very important source of cash income and thus potential savings. Market research is therefore essential, as is the need to cost and price any proposed products.
- In increasing numbers of districts in Bangladesh, the competition between MFIs has reached a level of intensity that threatens to undermine the industry. Clients choosing between as many as five or more MFIs in many villages, and clients belonging to multiple MFIs have risen to unprecedented levels. Sometimes as high as 40-50% of clients/households belong to two or more MFIs. This has led to many cases of over-indebtedness and appears to be undermining the primary incentive to repay, which is continued access to financial services. Increasingly, some clients appear to be willing to default with one MFI safe in the knowledge that they can access financial services from a competitor if follow-on loans are not made available. The microfinance industry in Bangladesh may well be facing its most profound challenge and threat since it began in Jobra in 1975.

This *MicroSave* Briefing Note was prepared on the basis of the ASA/*MicroSave*'s publication: “ASA's Culture, Competition and Choice: Introducing Savings Services into a MicroCredit Institution” available on *MicroSave*'s website: www.MicroSave.org under - Research Papers Section.

GRAMEEN II – MEMBER SAVINGS

Stuart Rutherford



GRAMEEN AND ‘GRAMEEN II’

The first Note in this series, ‘What is Grameen II?’ introduces the Grameen Bank and the changes it has made recently, known as the ‘Grameen Generalised System’ or ‘Grameen II’.

Some of the most important changes are in the bank’s new approach to **savings deposits**. Under ‘classic’ Grameen – the products and rules in force up to 2002 – Grameen took mostly obligatory savings from its members and stored them in accounts for individual members and in joint-owned ‘group’ accounts. The bank also offered some basic current and savings accounts to the general public, though not in great volume. Under Grameen II, it has introduced greatly expanded deposit opportunities to both members and the general public. And so, by end of 2004 total deposits (from members and from the public) exceeded the value of loans outstanding for the first time in the bank’s history. This completes the bank’s transition from a ‘microcredit’ bank to a true intermediary. Details about the public deposits can be found in another Note in this series, while this one describes the new member savings¹.

THE FOUR GRAMEEN II SAVINGS ACCOUNTS FOR MEMBERS

Under Grameen II, each member opens a *personal savings account*, into which she² may pay whatever she likes, subject to a weekly minimum that depends on the value of her loans from the bank, and withdraw whatever she likes whenever she likes, for any purpose, subject to being up-to-date in her loan repayments. Deposits are made at the weekly ‘centre’ meeting, but withdrawals are made at branch offices (normally within a half-hour’s rickshaw trip or so). When she takes a loan, 2.5% of its value is deposited to this account (but may be withdrawn). Deposits earn interest at 8.5% pa: a higher rate than passbook savings in commercial banks.

She also opens a *special savings account*. This account also receives 2.5% of the value of loans issued, and until it is three years old it is illiquid. After three years withdrawals may be made, subject to a minimum balance of 2,000 taka (about \$30). The account pays the same interest as the personal account.

A third savings instrument is available as an option, but becomes obligatory if the member holds a loan of 8,000 taka or more (\$130). This is the new *Grameen Pension Savings (GPS)*, a commitment-savings account based on the commercial banks’ ‘Deposit Pension Scheme’, long popular among middle and wealthy classes in Bangladesh. A fixed sum per month, minimum 50 taka (less than \$1) is deposited for a five or a ten year term, after which principal and interest – at a generous rate of 12% pa for the ten-year version (10% for five years) – are released, either as a lump sum or as monthly income.

Finally, borrowers of Grameen loans deposit into a *credit-life insurance savings fund*. These savings are held in the member’s name and the principal returned without interest when she leaves the bank. Meanwhile the interest is used to repay loans held by members at their death, so that heirs inherit the full value of any savings held but do not inherit the debt. In 2004, this scheme was extended to cover spouses living at home.

This Note focuses on the two main schemes, and tackles some questions that the researchers are often asked.

¹Notes in this series are based on the research project ‘Grameen II: A Grounded View’ commissioned in 2002 by *MicroSave* from a team lead by Stuart Rutherford. As the title implies, the findings are based on close research in the field, using interviews with staff, clients and the public in the areas served by three sample branches, and a review of the accounts of those branches, and of data from the Grameen HQ. We are grateful to the bank for the support it is lending to the research team.

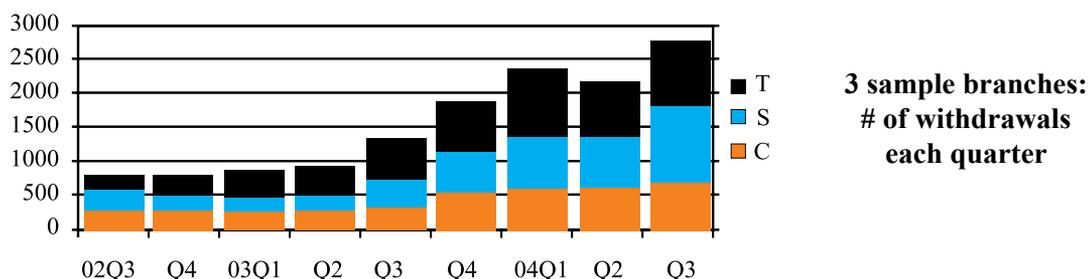
²Most, though not all, members are women.

THE PERSONAL SAVINGS ACCOUNT

The conversion from classic Grameen: When Grameen II started in 2002, branch staff transferred the old group funds and personal savings into 2.25 million new personal savings and the same number of special savings accounts. This huge task was carried out quickly and efficiently, as a graph as shown below. When we began our research in 2002, we found branch records and member passbooks in good order. There were very few complaints about how the conversion had been done.

The marketing of the account: An important aspect of the Grameen approach is that product rules are seen as a set of guidelines for branch staff rather than as a set of undertakings to clients. This allows staff to time the introduction of new products according to what they see as local conditions. But another outcome is that members may receive only a partial explanation of the product, and are dependent for their understanding of the rules on what staff choose to tell them. Printed sets of product rules are not available for members³. This policy helped shape the roll-out of the scheme.

Withdrawal symptoms: At first, many staff feared open withdrawals: they sincerely believed that members would quickly drain their accounts, leaving them with no reserves to fall back on, and Grameen with no implicit cash collateral for the loans. Then during 2003 some managers began to allow withdrawals for ‘approved’ uses, such as health emergencies and marriage ceremonies, while denying them for making loan repayment instalments. Finally in 2004 the product began to be administered as designed: HQ issued passbooks with the message that ‘you may withdraw cash from your personal savings at any time’ printed on every page. Staff learned that open withdrawal wasn’t the disaster they had feared. Members, finding withdrawals easier, began to use their accounts for the (often short-term) storage of larger sums, in addition to their small regular weekly deposits. The graph shows the growing number of withdrawals in our sample branches (referred to as T, S and C) from Q3 2002 to Q3 2004.



Balances: Average balances per member in personal savings accounts did not change much during this period: in two of our branches it grew but fell in the third, and ranged between 500 and 800 taka (\$8-13). Membership grew rapidly, pushing down average balances as new accounts opened, so it is clear that members did not choose to exhaust their accounts as withdrawals became freely available.

Uses: Mrs NB, a member in sample branch S, is one of the Grameen clients whose financial behaviour we are tracking. In 2004 her personal savings account transactions amounted to \$64 in 48 (mainly weekly) deposits and \$60 in 5 withdrawals, leaving her with a year-end balance of just \$9. She used the withdrawals for household consumption and health care, to lend to others, and to make repayment instalments to Grameen and other MFIs. The personal savings account, for her, is becoming a convenient current account. Large flows of cash in and out of such accounts, resulting in small balances, is both

³ Sometimes fieldworkers have no copy of their own: there may be one copy in a branch, used by the manager to train his staff).

common and rational among the poor, whose small and fragile incomes require them to resort to saving and borrowing to finance even small items of expenditure such as a visit to the doctor or the purchase of a new sari. This useful service did not exist in Grameen before Grameen II: but is now one of the bank's most popular products.

THE GPS

Savings as a growing financial asset: The GPS offers another entirely new, but quite different, form of saving service to Grameen members. It allows members to save up steadily over the long haul for large expenditures: marriage for daughters, careers for sons, and future business investments were the three uses most often quoted by our respondents. It features growing balances, and it already dominates the savings portfolios of our three sample branches, with shares of 35%, 38% and 43%, rising rapidly, and typically twice the share held by personal savings and by special savings.

Valued for its own sake? Do members open a GPS because they value it or only because Grameen insists on a GPS as a condition of loan taking? Our research shows that behaviour varies. Numbers reflect this. The weakest performer among our three sample branches, branch C, in a remote, poor and flood-prone area, has fewer GPS accounts per member (less than one account for each two members), a lower average GPS balance (at under \$35), and fewer large-denomination GPSs.

Members mention the GPS less often when asked about what they value in Grameen. Branch S, on the other hand, free of floods and an economic growth area, has 3 GPS accounts for every 5 members, and many high-value versions, pushing the average balance above \$65. There, we find members who have joined Grameen expressly to access a GPS, members who hold several accounts, and members who try to avoid taking loans, arguing that a GPS is far better home for spare cash than using it to pay off short-term loans. The common response to the question 'what do you think of the GPS?' is 'Grameen should have done it years ago'.

Even where GPS is not yet so highly valued, there is no doubt about the trend: the virtues of the GPS are becoming more obvious to members and staff alike⁴.

Difficulties: As other MFIs have found, combining a GPS product with loans that are also paid down in regular instalments can make it hard for members to meet both obligations regularly. GPS accounts in arrears began to grow in 2003, as members and staff prioritised loan obligations over those of the GPS. To deal with this, Grameen in 2004 distinguished the 50-taka a month GPS that is required for borrowers (now known as 'red GPS') from the voluntarily-held GPS. Account numbers have risen as many members have split one large value GPS into a 'red' and a voluntary account. This may be awkward administratively but it will make it easier to assess how members truly value the GPS.

As 2005 opens, we find that Grameen's savings portfolio has expanded enormously under Grameen II, from \$146 million in mid 2002 to \$344m at end 2004. Though deposits from the general public have grown faster, member savings nevertheless comprise \$229m, or two-thirds of the end-2004 total. Poor people's need to save has finally been met by Grameen's new willingness to offer them suitable vehicles – one of the most important outcomes of Grameen II.

⁴And to non-members. The GPS is not offered to non-members, but the better-off actively seek ways to get access, since the GPS pays interest rates well above those paid for a similar product in the commercial banks. These rates may need to fall if Grameen becomes too liquid with GPS deposits, and diversified fund management may become a more urgent task for the bank.

SHGs SHOULD BALANCE OR BREAK

Brett Hudson Matthews and Trivikrama Devi



In the words of NABARD, *“internal savings mobilised by its members is the core of the SHG¹”*. Banks size their loans to SHGs as a multiple of the savings accumulated. Strangely though, it is not routine for banks to verify SHG balance sheets before lending. Few SHGs try to balance their books, and even fewer have provisions for audits.

Auditing SHG balance sheets is vital for detecting errors, sloppy disclosure practices and fraud. It is the only way a bank can assure itself of a SHG’s capacity to repay in future. It is the only way members can assure themselves that their savings are really all present and accounted for.

In the SHG-bank linkage model, the size of bank loans is determined by the size of the SHG corpus, more than by any other single factor. As a result, SHGs face very strong systemic incentives to neglect errors that overstate their collective savings or understate losses.

The bank linkage programme has achieved rapid growth, with over 4 million groups “credit-linked”. But the lack of balancing or audit risks undercutting the evolving trust between rural poor people and banks. If there is inadequate money to pay all claims, should it be the lender or the SHG member whose obligations take seniority? Banks should not lend to SHGs if member savings may be at risk as a result.

SAVINGS REQUIRE A BALANCED FOUNDATION

Even though SHG members join groups primarily to access credit, they also believe that SHGs are useful for saving. In the past decade many microfinance studies have shown that poor people save at home in large amounts. This helps them achieve many critical goals. Savings drive health and education planning, large asset acquisitions like improved housing, transport or farm equipment, and preparation for expected or unexpected income gaps, among other goals².

Because SHG members have no way to confirm whether their savings are all accounted for, they cannot use SHG savings as a reliable foundation for accomplishing these goals. And it is equally impossible to build sustainable SHG federations on such an unstable foundation.

VERTIGO LEADS TO BREAKING

Decades of microfinance experience have shown that sooner or later, subsidised funds attract elite capture. The larger the fund, and the longer its life, the more robust the defences required to protect it. Bank linkage loans are very cheap compared to other options of villagers, so it’s natural that powerful villagers seek to corner the benefits. *“They get this money for nominal interest rates like 7% which they put in chit funds where they get returns of 30% or more. This is a big fraud on the system³”*.

In the first years SHGs build their internal savings to access bank loans. But gradually, devious people find the gaps in the control system. Transactions may increasingly take place outside meetings, or the group’s only record-keeper may leave. The longer gaps beckon and money piles up, and the clearer it becomes that no one is in control, the larger and more frequent the abuses can be expected to become.

Accumulating Savings and Credit Associations (ASCAs) in India have succeeded by staying short term. After 6-12 months of saving and lending they “break” by distributing all savings and profits to

¹ NABARD, SHGs-Banks Linkage Project. NABARD Regional Office, Bhopal, 1998, p. 5.

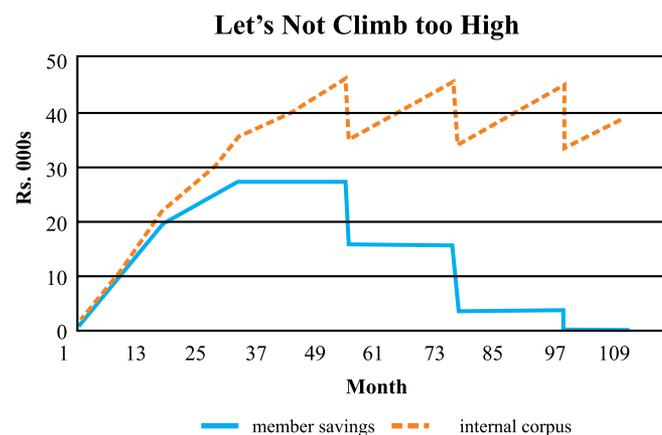
² Wright, Graham A.N., “The Relative Risks of the Savings of Poor People”, *MicroSave*, Kampala, 2000.

³ Somanath, VS of Nano Ventures, cited in “Microfinance Cos Sniff Big Biz”, TNN, 17 February 2009.

their members. While limiting options for long term savings, this provides an “action audit” and limits the risk of elite interest while neatly side-stepping the complexities of creating control systems for larger funds⁴. By breaking, ASCAs protect members’ rights to:

- receive all individual savings plus profits in cash, to use as desired without conditions,
- leave the group without conditions, and
- elect new leadership and accept new members.

Some SHG support institutions (SHPIs), such as BWDA and Chaitanya, require their groups to formally break. This responds to a felt need among members themselves. To avoid becoming targets for elite capture and other forms of misappropriation, members have for years engaged in incremental cash-outs



(as depicted in the graph). Member drop-outs are also high, in spite of the fact that drop-outs usually lose any claim to retained earnings inside the group⁵.

In practice SHGs limit the size of their corpus by withdrawing savings from the bank and distributing it. When their internal fund is large enough to lever the loans they want, they skip savings contributions or stop them altogether. Within a few years the savings exposure of members (as distinct from internally generated profits) can start to drop, and may eventually disappear altogether.

The 2008 *State of the Sector Report* has confirmed that rising delinquency is a trend across Indian SHGs⁶. By keeping savings amounts small, based on a belief that saving at home is probably safer, SHG members protect themselves from loss. Once members limit their savings commitments, attention paid to the group corpus and member solidarity drops, and the potential for delinquency rises steadily.

WHY SHGs DO NOT BALANCE

Compared to other record-keeping tasks of SHGs, preparing a balance sheet is a relatively infrequent event, and more challenging as well as abstract. Once an SHG has been operating for years without balancing, replacing old books with new ones on a running account basis, even an SHPI may shrink from the effort involved in balancing.

In addition, most SHPIs view external financing as the main source of funds for SHGs, rather than compounding of savings over time. They have neglected protection of the SHG asset foundation. They risk killing the goose that is laying the golden eggs.

CAN SHGs BALANCE?

Outside stakeholders often believe SHG members are not interested in or capable of preparing or

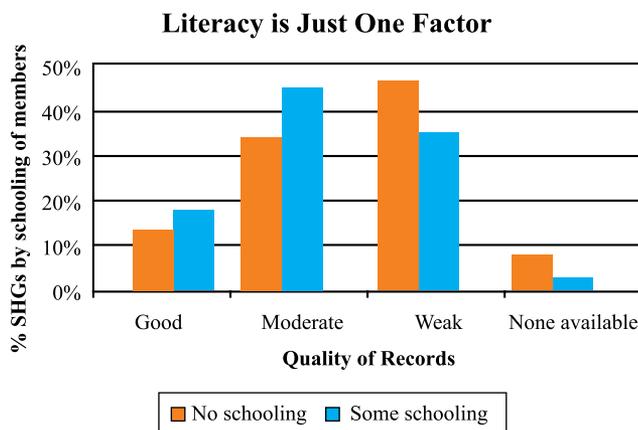
⁴ Rutherford, Stuart, “The Poor and Their Money”, Oxford University Press, Delhi, 2000.

⁵ Srinivasan, N. “State of the Sector Report 2008”, p. 23. Sage Publications, Delhi, 2009.

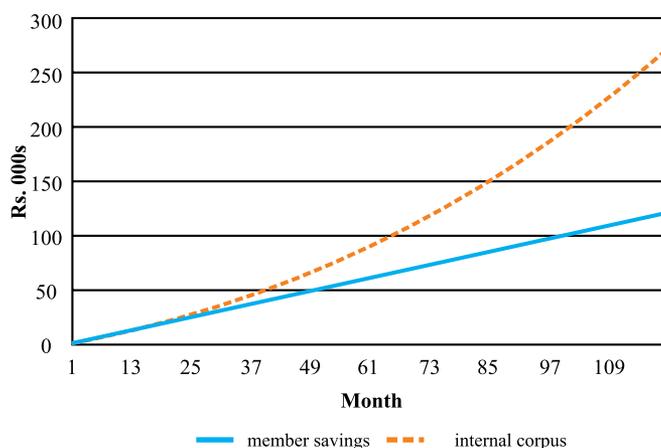
⁶ Srinivasan, N., p. 26.

understanding a balance sheet. Most SHG members, like most other people, do not enjoy basic book-keeping. But SHGs do not have to balance. MFIs/banks and SHG federations can do it for them and also charge them for the service.

Doubtless most SHGs will find balancing a daunting, even pointless exercise. But, studies of SHG quality by APMAS have shown that 15% of groups, or about 600,000 SHGs, have good records. Furthermore, the difference in record quality between literate and illiterate groups is not as great as sometimes believed (see chart)⁷.



Balancing Act?



WHICH SHGs SHOULD BALANCE, AND WHICH SHOULD BREAK?

If SHGs that have formed mainly to access bank loans break every few years, they can retain the confidence of lenders – and reduce their monitoring costs - without balancing. SHGs committed to saving are fewer. But identifying them and investing in their capabilities has key developmental benefits. A firmer foundation can be built, able to support greater local capital formation through compounding of retained earnings over time. This can help members achieve their savings goals, while fuelling village development through reinvestment of retained earnings (see graph).

In a recent paper⁸ CGAP suggested that banks are charging SHGs rates that would be unsustainable without subsidies. Regular breaking can be expected to reduce monitoring costs and delinquencies. Regular balancing will increase monitoring costs *and* the capacity of SHGs to borrow, repay, and purchase other financial services.

MANAGEMENT TOOLS

Unless they balance annually, SHGs should break every 2-3 years by providing an unconditional cash-out opportunity (or Rutherford’s “action audit”) to all members.

Unless a current audit is available from a trusted source, lenders should do the following before lending to SHGs:

- require it to break a minimum of once in 3 years;

⁷ EDA Rural Systems and APMAS, “Self Help Groups in India: A Study of Lights and Shades”, Delhi, 2006, p. 106.

⁸ Isern, Elizabeth, Robert Peck Christen et. al., “Sustainability of Self-Help Groups in India: Two Analyses”, CGAP Occasional Paper #12.

- prepare a field balance sheet;
- verify loan amounts by random sampling of members' passbooks and testimony in private, in their homes;
- total all savings contributions based on the number of members and the number of expected contributions;
- add reasonable expected profit based on rates charged on loans and compare the total to the actual corpus; and
- make sure all old cash ledger books have been tallied and signed off by a trusted source.

SHGs that want to protect savings enough to limit their consumption of credit should be taught how to balance:

- The steps involved in balancing can be analysed by SHPIs through process mapping.
- SHPI facilitators should identify through groups of non-literate SHG members ways of tracking balances.
- Focus groups of non-literate members can also identify ways to transparently present balance sheet results.
- A cadre of private-sector *munshis* can be developed to check balance sheets periodically.
- The most effective auditor may be a local school-teacher or an SHG leader from another village.

REACHING REMOTE AREAS – A CASE FOR NORTH EAST INDIA

Abhijit Sharma¹



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BACKGROUND

It is now generally accepted that, without access to financial services for the vast majority of population, they are left outside the growth process. Hence, one of the goals for national growth is “financial inclusion”, and countries across the world, including developed ones like UK and USA, have now incorporated this as one of their national goals. It is in this light that financial inclusion and reaching remote areas assumes special significance in a developing country like India.

Financial inclusion is the delivery of financial services at an affordable cost to disadvantaged and low-income groups. Unlike earlier approaches that emphasised impact without focussing on outreach or sustainability, this approach places emphasis on financial sustainability as the key. For without sustainability, capital constraints mean that reaching larger numbers will be impossible ... grant-based approaches will be, by definition, rationed.

THE CONTEXT

For all the efforts of past and present Governments, the North East region remains a classic case of financial exclusion. Despite the professed aim of providing universal access to finance, supply-driven approaches have failed to increase outreach. Key indicators remain clearly are much lower than the national average.

States	Savings A/Cs per 100 adult population (2005)	Credit A/Cs per 100 adult population (2005)	Households covered by banking services (2001)
India	59.3	13.3	35.5
NE India	39.3	6.7	21.1
Manipur	19.5	4.0	8.7

Sources: Report on Financial sector reforms for NEI (2006) and Census of India, (2001)

With the exception of just two districts of the North East, the credit per capita is lower than the national average: some districts have a credit per capita of Rs.200 compared to the national average of Rs.12,500. Worse, several key indicators are moving in the wrong direction, for example, in contrast to the rest of the country, there has been rapid withdrawal of banks from offering/ maintaining “small accounts” (<Rs.25,000) in the region. This has been primarily because most of the banks, in the face of declining profitability in the region, concentrate only on larger and “safe” customers. Thus for all the rhetoric and good intentions, the North East is back from where it began. Most of areas have not been touched, or are being increasingly left out, because it is “not profitable”.

The location of the region, with almost 70% hilly/poor infrastructure and 98% bounded by foreign countries, makes markets in the rest of India difficult to access. It is thus almost inevitable that most economic activities remain at small scale. The immense diversity of the region in terms of its physical, social and economic characteristics also creates another disincentive to “scale up” operations. Despite the best intentions, the spread of bank branches has also been much below the national average; and in some states like Manipur bank branches serve 2.5 times as many people as the average benchmark for the country as a whole.

Despite (or because of) these conditions, micro- and small enterprise thrives in the North East. The Government of Assam statistics of 1998-99 shows that micro-enterprises contribute more than Rs.30

billion to the state GDP each year². Most of these enterprises are serviced by the informal financial sector. The informal financial market is characterised by its variety (both in terms of sources and products) reflecting the diversity of the region. Studies³ estimate the microfinance market to be around Rs.26 billion or more. While informal finance is ubiquitous, it is more vibrant in the valley regions, which have higher density of people and activities. Thus, contrary to the banks' assertions, financial markets do exist and can be characterised as follows:

1. Most of the financial requirements are small and frequent.
2. Markets are specialised or 'niche' particularly for the hilly regions.
3. Banks have hardly been able to penetrate this market given their thinly spread of branches and inappropriate products.
4. The region is rich in traditional institutions, some of which are involved in financing.
5. Women are more actively involved in the economic activity than in other areas.

MICROFINANCE IN THE REGION

The North East therefore has the appropriate conditions for the growth and development of microfinance. The microfinance movement started late in this region and, to date, has been primarily focussed on Self Help Groups (SHGs). However, given the reliance of the SHGs on the availability of bank branches, it is obvious that the movement would be restricted to places that have a higher concentration of branches - the valleys and in the urban areas of the hilly areas. Even within Assam, it is concentrated in economically vibrant areas of Lower Assam. The cost of promotion of SHGs in most parts of the hills is prohibitive, and the grants available to promote the SHGs are usually much lower than the cost. This reduces the incentives/ability to promote effective SHGs - hence the slow growth in the region.

Even though growth of SHGs has been high in Assam, it has been erratic. One of the major reasons for this has been because the bank branches with 2 or 3 employees are not equipped to handle large number of SHG accounts, and so they stop accepting new ones after a critical mass has been attained. The second major reason is that despite the hype associated with high repayment of SHGs, the PAR of some sample branches is around 43.1% and 69.1% (for RRBs and commercial banks respectively). This, however, drops to 19.5% and 19.6% for RRBs and commercial banks after 90 days (i.e. the time when the trigger mechanism for banks' normal loans is activated). Furthermore, the SHGs (primarily in Assam) have also adopted a habit where only the interest is paid monthly and the principal is paid in a bullet payment at the end of the loan. All these factors increase the inherent risks of SHGs and make them a less attractive proposition for rapid scale-up and expansion.

In addition, the diversity of the region means that a one-size-fits-all SHG product would not be able to meet all the requirements. This was clearly illustrated in Mizoram, where a small change in the delivery system, from SHG-based to a joint liability group-based (Grameen Bank) approach, led to a growth of 3,378.6% of groups accessing credit and 2,158.5% growth in advances to the groups in a single year (2005-06).

As a result of the growing understanding of a range of effective microfinance products and delivery systems, there are now more than 365 NGOs/institutions offering microfinance services in the region ... and more than 50% of these started operations after 2000. These organisations are market driven in their approach, but have limited knowledge and skills to upscale their operations – capacity development and technical assistance will be essential to assist them reach scale. Furthermore, these inputs cannot be

² District potential survey for Rural Non Farm Sector for Jorhat District, IIBM, page 17.

³ Expanding outreach to underserved regions: Kick-starting microfinance in North East Region of India, An Evaluation of the Microfinance Sector of the North East India: Scoping Task for SEDF.

delivered on a “cookie-cutter” basis, but will require careful analysis of local operating conditions and realities in a way that has rarely been seen in India to date.

THE WAY FORWARD

If the objective is to reach the maximum numbers in a sustainable manner, the key will be to use different strategies for areas with a cash-based economy, and those areas with limited cash. Current best practice models (such as joint liability, group-based systems) can indeed be replicated in the areas, (typically the plains and valleys) with a cash-based economy. However, in order to make microfinance institutions (MFIs) sustainable, and also to meet the wide variety of unmet needs in these areas, a wider market segment than the traditional poor microfinance clientele must be served⁴. Thus MFIs need to focus on vertical growth as well as horizontal expansion, and to develop a broader product suite for different clients.

In low cash economy areas like the hills, initial focus will have to be on the urban areas where the cash economy is more active. However, in order to make institutions viable, it will be essential to cater to an even wider segment of clients with a product suite to meet their diversified needs – an option that is made feasible by the withdrawal of the banks. For many areas with a limited cash economy, traditional organisations and financial products need to be harnessed and promoted for financial intermediation, since these offer low cost alternatives to more formalised, centralised systems. This will require more research to understand these organisations. Also, with the spread of mobile networks, e-banking may offer another attractive proposition⁵.

However, a few conditions need to be put into place for the interventions to be effective. They are:

1. Developing a tool designed to identify and assess institutions that are carrying out low level financial intermediation, but have potential for greater scale based on their unique position and products.
2. Start-up funds for institutions that want to scale up their operations quickly.
3. Capacity-building funds for building MFIs so that they can scale up effectively.
4. Funds for allowing experimentation on delivery of services and products.
5. Local (North East-based) technical assistance and capacity development providers.
6. Building institutional mechanisms to take this forward.

⁴ See *MicroSave's* Briefing Note # 7 “Are You Poor Enough?: Client Selection By MFIs” for a detailed discussion of these issues.

⁵ See *MicroSave's* India Focus Note # 4 “E-banking: The Next Revolution?” for a discussion of the opportunities and impediments to this.

THE RELATIVE RISKS TO THE SAVINGS OF POOR PEOPLE¹

Graham A.N. Wright and Leonard Mutesasira



¹ This Briefing Note was developed on the basis of a full paper by the same name available on *MicroSave's* website: www.MicroSave.org under Research Papers Section.

BACKGROUND

Increasingly, Microfinance Institutions (MFIs) have come to recognise the need to provide savings services – both as a much valued service to their clients, and as a long-term source of capital. This has led to growing interest in savings, Vogel’s (1984) “forgotten half” of microfinance. As a result of the new attention to savings services, a great deal of time and energy is being spent by Central Banks, donors, consultants and MFIs on developing systems for regulating and supervising MFIs offering savings services.

Central Banks’ motivations to regulate MFIs (or indeed any other financial institution) revolve round two primary aims:

1. to protect the integrity of the country’s financial system (i.e. to guard against “systemic risk”), and
2. to protect depositors within a context of asymmetric distribution of information (i.e. to guard against depositors losing their savings in the event of the failure of financial institutions).

In most countries, (with the exceptions of Indonesia, Bangladesh and possibly Bolivia) MFIs simply have not reached the scale or achieved the breadth and depth of market penetration to pose any systemic risk. It is therefore the laudable desire of Central Banks to “protect depositors” that is the credible rationale for their efforts to regulate and supervise.

Poor people have limited access to formal or semi-formal financial services (indeed this is the basic rationale for the development of the microfinance industry). Poor people therefore lack formal financial service alternatives to the MFIs. If MFIs are prohibited from offering savings services to poor people, those poor people are forced to resort to the informal sector in order to save.

It is clear, and now generally accepted, that poor people want, need and do indeed save. There is also increasing evidence that poor people are facing an extremely risky environment when they save in the informal sector. Thus it is clear that when discussing the risk to poor people’s savings, this has to be evaluated on a relative basis. Very often all the alternative savings systems available to poor people are risky ... thus poor people are left facing decisions on the *relative risk* (or relative security/safety) of the various semi and informal savings systems open to them.

METHODS

MicroSave used its existing extensive qualitative data set (comprising over 500 group interviews [with groups averaging 6-8 people] and another 200 plus individual in-depth interviews) and complemented these with an additional 19 focus group discussions and participatory rapid appraisal exercises explicitly designed for this study. This qualitative work was complemented by a quantitative component. A private sector market research company, Research International was hired to carry out the quantitative component of the study, which was based on 1,500 face-to-face interviews among adults in Central, Eastern and Western Uganda.

RESULTS

The research revealed that 99% of clients saving in the informal sector report that they have lost some of their savings and on average they had lost 22% of the amount they had saved in the last year. 15% of those saving in the formal sector report that they had lost some savings and 26% reported that they had lost savings in the semi-formal sector. Thus the formal sector, for those lucky enough to have access to it, is safer both in terms of likelihood of losing any savings and in terms of the relative loss (amount lost to amount saved). Those with no option but to save in the informal sector are almost bound to lose some money – probably around one quarter of what they save there.

People who have access to the formal sector reported saving three times as much (\$386) in the last 12 months than those who saved in the semi- and informal sectors. The people saving in the formal sector also reported a lower incidence (15%) of loss and a lower rate (3.5%) of loss in the last year.

DISCUSSION AND CONCLUSIONS

What It All Means for Central Bankers

It is clear that commercial banks and the few larger MFIs that have transformed into a status that brings them under the supervision of Central Banks will never be able to reach out to offer savings services to poor people in remote rural areas. Indeed, with the increasing closure of rural commercial bank branches throughout Africa, the trend is the reverse. So some creative thinking and flexibility is required to address this issue. It is not good enough to say, “We cannot guarantee the security of your deposits at unsupervised institutions, so you cannot save with them” – this simply drives people into (or strands them in) the highly risky informal sector.

For too long, Central Bankers have seen depositor protection in absolute terms: ***when considering “safeguarding the deposits of the poor”, it is essential to think in terms of relative risk rather than absolute risk.*** In the same way that rich people make investment and savings decisions on the basis of the relative risk and return on the variety of opportunities available to them, so poor people are constantly faced with the need to assess the relative risk of the limited options they have to save.

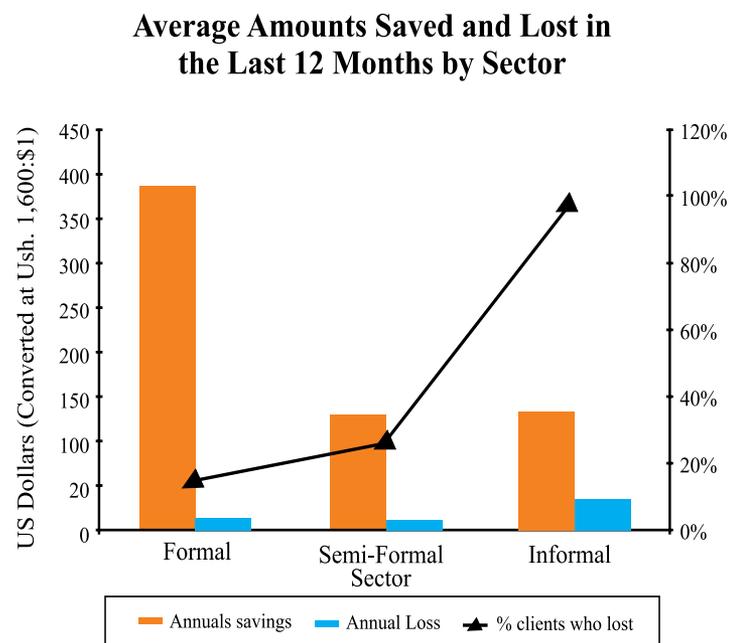
What It All Means for the Microfinance Industry: Most would agree that smaller MFIs are risky institutions to which to entrust savings. However, as can be seen from the analysis above, on a relative basis, many are likely to be safer than the most common informal mechanisms the poor are forced to use by policies that prohibit MFIs from mobilising savings.

This is not to suggest that no efforts should be made to identify and close down semi-formal institutions that are deliberately seeking to defraud poor people of their savings. However, it is necessary to recognise that ill-considered, draconian prohibition of deposit mobilisation: *neither* prevents such institutions starting up in areas where there are no (or limited) formal/semi-formal alternatives for poor

people – for example most of rural Africa, *nor* protects poor people’s savings but instead leaves them in informal systems with a high relative risk.

In view of the highly risky nature of saving in the informal sector it is probably necessary to think more about helping clients understand the relative risk of saving in these semi-formal institutions. It should also be noted that the evidence from this study suggests that poor people do value some form of external accountability.

Clearly, this type of external accountability increases the trust of poor people in the institution



and thus facilitates the institution's savings mobilisation activities. Thus serious semi-formal sector MFIs should want some form of external accountability.

It is important to improve internal supervision (accounting systems, internal control, governance, adequate transparency to allow members to make their own decisions about the risk associated with saving in the institution etc.). At the same time the microfinance industry has to search for alternative and appropriate approaches to external supervision, probably a voluntary system based on decentralised, non-governmental bodies.

That said, poor people cannot wait for the perfect system to protect their deposits ... indeed, the evidence from the formal commercial sector demonstrates that this panacea does not exist. In the short run, it is preferable to give poor people the choice rather than drive or strand them in the high risk saving environments with which they are currently faced. We must however, seek to inform that choice so that they can make their own decisions about the options available to them and the relative risk of each.



“Once again, it is time for the microfinance industry and the central bank to think “outside the box” and understand the issues from the perspectives of the end-user. Failure to do so could mean that well-intentioned regulations will trap poor people in the relatively high risk informal sector and prove once again that “it is expensive to be poor”.”

Mutesasira and Wright, 2002

SAVINGS SERVICES FOR THE POOR – AN OLD NEED AND A NEW OPPORTUNITY FOR MFIs IN INDIA

Sanjeev Kapoor



Microfinance in India has brought a revolutionary shift in the approach to providing financial services to the poor. Over the past decade, it has been claimed vigorously that microfinance has had a positive impact on the poor in terms of increased household income. However, focusing only on static measures of household earnings and income ignores the other side of poverty, the vulnerability of the poor to risk. Unfortunately, in India microfinance remains primarily a supply-driven, credit focused endeavour, with a limited number of methodologies applied to provide mainly working capital loans to poor women. Over the past few years, the focus of microfinance in India, as elsewhere, has shifted to providing a wider range of financial services to a diverse group of vulnerable households engaged in complex livelihoods. With this perspective, practitioners in microfinance industry have recognised that the poor require a range of financial services to manage risks and thus, in the long run, improve the quality of their lives.

In terms of risk mitigation, savings appears to be the most desirable and effective strategy for poor households to avoid potential loss of economic status or independence as a result of a crisis. While microcredit has proved to be a valuable and effective way to protect the poor against risk in an *ex ante* sense (ahead of time), the limited credit products offered by most of the microfinance institutions (MFIs) in India are less suited to provide poor households the support needed after a shock (*ex post*). The time difference between the shock and the response by way of securing a loan makes formal credit a less useful option.

The importance of savings to allow poor households to reallocate expenditure across time has been persuasively articulated by Rutherford (2000). Using three different approaches, namely “saving up”, “saving down”, and “saving through”, the author has demonstrated that agglomeration of money is the basis for all financial services that the poor require to smoothen inflows and outflows in the household economy¹.

A study by the author on understanding saving behaviour of rural poor and urban slum dwellers in Uttar Pradesh indicated that there was a significant variation in the flow of income and expenditures (both in terms of time and magnitude) in the households for all livelihood categories. There were several time periods when the expenditures outweighed the income stream. This was exactly the time for which most of the rural households wanted to save ... so that they could meet the inevitable expenditures with the help of their past savings - at least to some extent, if not fully.

The debate whether poor can save or not has become obsolete. Large scale success of Self-Help Group (SHG) movement has proven the ability of the poor to save. Although poor households have fluctuating amounts of surplus cash available, women are able to save a fixed amount on a regular basis in their groups. This is possible due to the regular discipline promoted in the SHG approach. However, there is an inherent limitation in the SHG methodology for providing saving services to rural poor. The SHG approach enables savings to accumulate in the form of a corpus to be managed locally by poor and often illiterate women. It requires considerably high level of trust, confidence and financial management skills amongst the members.

Our observations from field study confirm that SHGs can provide only a very limited saving service. In the course of our discussions with a large number of women members of SHGs, it became clear that women wanted to save more money on a regular basis for needs like illness and other emergencies, as well as for long term needs like marriage of their daughters and their children’s education. However, interestingly, when the possibility of increasing the amount of instalments within the SHGs was

¹ See *MicroSave* Briefing Note # 13 “Money Managers: The Poor and Their Savings”.

discussed, members did not seem to agree. This aversion to entrusting larger instalments of savings to SHGs might be because of lack of trust and confidence required amongst the members to manage large amounts of corpus money. It emerged that the SHG channel for savings may be appropriate so long as the savings of individual member remains small. The staff from the Self Help Promoting Institution also felt, perhaps rightly, that very large amounts as corpus funds in SHGs become unmanageable for the members, and at times leads to differences within the group and eventual break-up of the groups. Thus, SHGs can provide a limited risk management fund for poor women by providing small-sized loans through mobilising small amounts of savings. But, there is still a crying need, and ample potential, to meet the real saving needs of rural poor. However, a major portion of the potential remains untapped; a trend clearly reflected in the market research exercise which bought out the need and desire of rural/urban poor households to save. However, to date, access to suitable and reliable saving services for the urban/rural poor in India, is unfortunately very limited, or non-existent.

MFI in India typically offer a variety of loan products to the rural poor. Today these organisations are struggling with a challenging question: should they offer savings products also; and if so, what types of products, and how? The biggest bottleneck in Indian microfinance industry is that mobilising savings from the clients is not a permissible activity for MFIs registered as Societies, Trusts or Section 25 Companies, especially in the light of the amendment to Section 45S of the Reserve Bank of India (RBI) Act.

Similarly, the larger MFIs are transforming to become NBFCs in order to meet their lenders' requirements to strengthen their institutional form. While these larger MFIs typically have the more robust systems and management, and are thus better suited to offer savings services, they too are not permitted to mobilise deposits.

In a major step forward, January 2006 RBI permitted deposit mobilisation by MFIs appointed as Business Correspondents by the banks (RBI/2005-06/288, DBOD.No.BL.BC.58/22.01.001/2005-2006, dated January 25, 2006). The salient features of this circular can be summarised as follows:

- NGOs/MFIs set up under Societies/Trust Acts; Societies registered under Mutually Aided Cooperative or the Cooperative Societies Acts of States; Section 25 companies; registered NBFCs not accepting public deposits; and Post Offices may act as Business Correspondents. However, NBFCs were debarred from acting as Business Correspondents by a subsequent circular issued in March 2006.
- The scope of activities to be undertaken by the Business Correspondents will include: (i) disbursement of small value credit; (ii) recovery of principal/ collection of interest; (iii) collection of small value deposits; (iv) sale of micro insurance/mutual fund/ pension/other third party products and; (v) receipt and delivery of small value remittances/other payment instruments.
- Banks may pay reasonable commission/fees to the Business Correspondents, the rate and quantum of which may be reviewed periodically. However, the agreement with the Business Correspondents should specifically prohibit them from charging any fee to the customers directly for services rendered by them on behalf of the bank – a provision that has discouraged many MFIs from acting as Business Correspondents.

Designing saving services for rural clients requires new products and innovative distribution mechanisms. There are two important facts which have to be addressed while designing delivery channel for saving products to rural customers:

- The clients are spread over a large geographical area, and collection needs to be frequent.

- Business with each client is very small in value, and often high in volume.

After the introduction of “Banking Correspondent Model”, financial institutions can start collaboration with MFIs/ NGOs. This partnership is very advantageous for the financial institution, the MFIs and their clients. The financial institution gains access to new markets with reduced transaction cost; the MFI can expand the portfolio of its financial products and gains a new income source; and the clients accumulate a large pool of money over time by accessing an alternate and more robust savings channel.

MFIs may (rightly) apprehend the increased chances of fraud in their organisation, in response to which they will need to develop stringent internal control mechanisms to manage the provision of savings services. However, this has been done before in many places and there are plenty of lessons that can be learned ... without bitter experience²...

² See *MicroSave* Briefing Note # 3 “Introducing Savings into a MicroCredit Institution – Lessons from ASA”.

BACKGROUND AND SIGNIFICANCE

The Reserve Bank of India (RBI) has encouraged the use of Business Correspondents (BCs) as a means for promoting financial inclusion in India. This IFN examines the viability of the BC model for MFIs, based on field experiences in India.

WHAT IS A BUSINESS CORRESPONDENT?

A BC provides banking services to clients on behalf of a bank¹. NGOs, MFIs set-up under Societies² / Trusts Act, Co-operative Societies and Section 25 Companies can work as BCs.

PRODUCTS ON OFFER

On behalf of a correspondent bank, a BC can collect small value deposits, disburse and recover small value loans; receive and send small value remittances; cross-sell third party products such as micro insurance, mutual funds and pension products, and engage in bill payments for services.

STAKEHOLDERS INVOLVED IN BC MODEL

A typical BC model has three stakeholders:

- Banks** are interested in BC relationships so as to reach the unbanked, generate additional deposits, and sell other banking services.
- Correspondents** earn commissions from the enrolment of clients, transactions and deposits.
- Technology Providers** act as interface between the correspondent and the bank - responsible for providing technological solutions such as the authentication device³ and client cards⁴. FINO⁵ and ALW⁶ are the two leading technology providers.

The profile of the organisations where BC model was reviewed:

	<i>Drishtee</i>	<i>Prayas JAC</i>
Profile		
Legal Entity	NGO	NGO
Operational Area	11 States	Delhi
BC of	State Bank of India	ICICI Bank
Operational Unit	Kiosks	Branches
Technology Provider	ALW	FINO
Products - Savings		
Zero Bal Savings A/c	TINY	<i>APNA</i>
Normal Savings A/C	Yes	No
Term Deposits	Yes	No
Recurring Deposits	Yes	No

¹ See RBI circular RBI/2005-06/288; DBOD.No.BL.BC. 58/22.01.001/2005-2006.

² RBI has advised banks not to engage NBFCs as banking correspondents.

³ A typical authentication device includes a biometric fingerprint reader, thermal printer and GPRS mobile phone.

⁴ Client cards are cards given to the clients by the bank for data storage and identification.

⁵ Set up in 2006, FINO works on developing solutions for the banks working with rural poor on BC model. One of the solutions developed by it is a personalised biometric smart card that is provided to each customer to act as a digital passbook for transactions.

⁶ A Little World is a technology provider, that works with banks and government schemes to provide low cost technology solutions for data management and authentication of poor clients availing financial services.

Products - Others		
Bank Loans	Yes	No
Insurance	No	No
Mutual Funds	No	No
Transfers	No	No

TYPICAL DELIVERY MODEL

- Clients are enrolled by the BC after a thorough verification of the documents. Some banks charge enrolment fees (ICICI Bank charges Rs.200 per client, while SBI charges nothing).
- A card containing information about the client and the transactions is issued to the clients.
- All transactions are conducted at the BC's office and at the end of the day, the BC settles its account with the bank. The BC has to deposit money, if deposits are greater than collections. Otherwise, the bank deposits the difference to the BC's account on the next day.

KEY GROWTH IMPEDIMENTS

Policy level:

- **Operational Limit:** One of the major setbacks for the model has been the operational limit of 5 kms for urban areas and 15 kms for rural areas for a BC by RBI.⁷ Demonstrating the RBI's desire to respond to challenges in the BC model, this has now been marginally relaxed to 10kms and 30kms⁸ respectively but still remains a significant limitation.
- **No Fees:** Another serious challenge to the BC model has been the prohibition of charging fees to the end user, which has made the development of a viable business model extremely challenging. As a result, it appears that many banks are offering "No Frills" accounts through the BC model as part of their corporate responsibility in response to RBI's pressure to promulgate financial inclusion. The current model creates incentives for both banks and BCs to open "No Frills" accounts (to report to the RBI and to gain the account opening fees from the bank respectively) and then to let the accounts lapse into dormancy – a pattern clearly seen across India.

OPERATIONAL LEVEL

- **Processing Time:** It often takes almost 2-3 months to either activate the account or deliver activated cards for many of the clients - unsurprisingly, many accounts go dormant as a result.
- **Account opening fees:** Clients are apprehensive about the account opening fees charged by ICICI Bank. Public sector banks such as SBI, Union Bank of India, Vijaya Bank do not charge any fee for opening a zero balance account.
- **Island account:** Clients expect banks to offer cheque deposit facility as well as ATM Card. They complain that the card cannot be utilised anywhere else except BC's office, thus it has a very limited use. Many clients note that if the account is not networked with the rest of the banking world as other bank accounts are, they would not accept it as a bank account.
- **Deposits:** Some BCs do not allow any other than the account holder to deposit. It is impractical to expect clients to come to the branch every time they want to deposit.
- **Evidence of transaction:** Fixed Deposit (FD) clients get a print out/mini statement on a thermal print paper that lasts for a couple of days. Thus, the clients feel that the investment is insecure in absence of a lasting evidence of transaction.

⁷ RBI Vide Circular - RBI/2007-2008/295 DBOD.No.BL.BC.74 /22.01.009/2007-2008.

⁸ RBI Vide Circular - RBI/2008-2009/455 BOD.No.BL.BC.129 /22.01.009/2008-2009.

VIABILITY OF BCs

Cost benefit analysis of BC at Drishtee and Prayas JAC demonstrate that the model as a standalone unit⁹ may take a very long time to break-even. The analysis reveals that the gap between the revenue and cost widens with increasing scale, which may further discourage MFIs to continue as BCs. A similar trend was observed for a kiosk (operational unit of Drishtee).

Also, as the kiosks were suffering losses, Drishtee itself also demonstrates a similar trend of growing losses over time as the BC model is rolled out. However, if Drishtee included micro-credit operations with its BC kiosks, then the breakeven period reduces significantly. Similar results have been seen in the BASIX group's KBS.

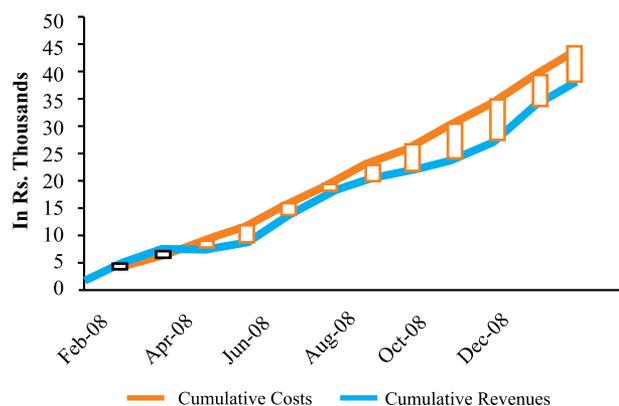
CONCLUSION

Experience to date suggests that BC operations in its current shape (primarily savings) might be viable only in a longer term perspective. Also, the real issue is to how to convert clients with zero-balance accounts and low-balance accounts into higher balance users as long as they face the problem of 'island accounts', 2-3 month activation lags. This model may be viable in a shorter run, if:

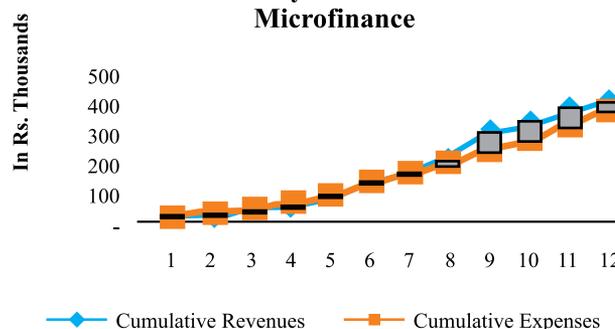
- Banks/BCs are permitted to charge small scale fees for the services they provide (there is broad consensus that the poor would be happy to pay such fees for a quality savings service)
- BC is taken up as one of the few activities by the correspondent with optimal cost-sharing arrangement among different business activities and the BC starts cross-selling other financial products which adds up to BC's business by providing commissions:
- Banks/BCs conduct research to understand the real needs and aspirations of the poor and tailor products to respond to these.
- Added to these the BCs might need capacity building in the areas of mobilising deposits and the banks can think of using core banking solutions to provide better services to the clients belonging to lower end of the spectrum.

These steps could add immense value to the business of BCs/MFIs resulting in symbiotic benefits for their operations ... and real and rapid financial inclusion in India.

Cost Benefit Analysis of a Drishtee Kiosk - BC



Cost Benefit Analysis of Drishtee - BC and Microfinance



⁹ Here standalone unit means that the agency offers savings products singularly and not juxtaposing it with other line of activities and revenue streams such as micro-credit.

MAKING BUSINESS CORRESPONDENCE WORK IN INDIA

Carolina Laureti and Brett Hudson Matthews



BACKGROUND

As of 2007, 46% of the adult population in India lack a savings account¹. The Business Correspondent (BC) initiative in India is a regulator-led effort to address the lack of convenient savings services for low income people. It was launched in January 2006², but subsequent performance has disappointed. Many stakeholders now concur that the BC model must be transformed from its current status as a “social add-on” into a sustainable business³.

This India Focus Note summarises the findings of a 3-month project by *MicroSave* India to clarify prospects for a sound business model for BC operators under current regulations. The study analyses three diverse cases that involve differing institutional arrangements and strategies for sustainability.

Eko – Eko Aspire Foundation and Eko India Financial Services Pvt. Ltd. were formed in September 2007 to extend banking facilities in unbanked areas via mobile phone-based technology and a network of retail outlets called customer service points (CSPs). As BC to the State Bank of India, Eko is now piloting a ‘No Frills’ savings account⁴ in Uttam Nagar, a suburb in west Delhi⁵.

Prayas – Prayas JAC is a Delhi-based NGO that started its BC operations towards the end of 2007, partnering with ICICI Bank in two of its branches in Jahangir Puri and Bawana. Prayas offers the ‘APNA’ no frills bank accounts using a point-of-sale (POS) device, a dedicated smart card for each client, and biometric authentication. The technology is supported by FINO.

Drishtee – Through its network of village-based service delivery agents or ‘kiosks’, Drishtee Development and Communication Ltd. is delivering its own microcredit product. It has also partnered with two banks (SBI and HDFC) to deliver ‘No Frills’ savings accounts. Its POS-based technology is provided by A Little World (ALW).

METHODOLOGY

The study firstly estimates, for the three business models, costs and revenues of the current BC business (“reference” period) consisting in delivering no frills bank accounts with only cash withdrawal/deposit facility. It then analyses the behavior of costs and revenues under various scale-up scenarios in an effort to identify general principles for BCs that wish to achieve sustainability.

All parties (BCs, banks and technology companies) must make money. An important assumption in modeling was that the current offer prices of banks and technology companies do not change during scale up. Since the focus is on sustainability of the BCs, these prices can then be treated as a proxy for the sustainability of other players in the model.

REVENUE: TRANSACTIONS OR BALANCES?

Bank commissions are the primary source of revenue for BCs. They are usually based on the number of new clients enrolled, the volume of transactions, and client balances. Each BC may also sell a limited number of products other than the ‘No Frills’ account (for example, recurring deposits or insurance). The table summarises revenue structures for the three cases:

¹ Report on Currency and Finance (2006-2008), Reserve Bank of India.

² RBI/2005-06/288 (RBI Circular dated January 25, 2006).

³ As evidenced at the recent policy retreat on BC/BF (CGAP/Access, at the College of Agricultural Banking, Pune) on May 15th, 2009.

⁴ ‘No frills’ accounts are low cost accounts requiring no minimum balance.

⁵ The Eko business concept is detailed by Sanjay Bhargava et. al. in 5 Whitepapers on Financial Inclusion (posted on the Eko website).

Basis of Commission Payments	Eko	Prayas	Drishtee
Client enrolment (per new client)	Rs.10	Rs.30	Rs.10
Per transaction	None	Rs.1	None
On value of transaction	0.5%	None	0.5%
On balances outstanding (quarterly)	None	2%	None
On active accounts (quarterly)	Rs.40	None	None
Other revenues BC business	Yes	Yes	Yes

Note: Drishtee and Eko then pay commission to their agents and super agents from these revenues

There are two revenue models: one based on the value of transactions and the other based on the value of balances.

- The transaction-based model ties BC earnings directly to work activities performed. A commission of 0.5% on deposits and withdrawals discourages transactions of less than about Rs.150-200. Sadly, recurring deposits of less than Rs.100, which might appeal to poor savers, could bankrupt the BC as the cost of service delivery exceeds the income.
- The balance-based model (Prayas—ICICI) ties BC earnings to the overall balance/health of their clients' accounts. While this creates incentives for BCs to invest in client education, balances may be very small at first even if transactions are frequent. This makes the path to sustainability slower and less predictable.
- Revenues earned by the BCs from their agents (licensing and franchise fees, security deposits etc.) have no material impact on the profitability of the business models studied.
- Client enrollment fees are valuable but supplementary.

COST DRIVERS

The chart presents the 7 cost categories of the models studied.

	Description	E	P	D
1. Fees to agents	Payout to the retail outlets (typically a portion of the commission the BC Company receives from the bank).	✓+		✓+
2. Marketing/ promotion	Financial education of customers, promotional materials (sign boards and pamphlets), and call center (for customer queries, grievance and satisfaction).	✓+		
3. Channel management	Identification and training of agents and service personnel. Monitoring of outlets' on-going performance, client satisfaction and service quality.	✓		✓
4. Processing transaction cost	Opening/closing of accounts, processing of cash withdrawal/deposit. Transport and insurance costs to handle cash. Cost of balancing the cash in the till.	✓	✓+	✓
5. Liquidity cost	The opportunity cost of working capital required to meet cash withdrawal needs of the clients.		✓	✓
6. Technology cost	Hardware: front-end and back-end devices, communication hardware. Software: platform's development and maintenance and integration with bank data system (Core Banking System).	✓		
7. Overhead cost	Back office staff, running costs of the offices and depreciation of capital investments.	✓	✓	✓

E = Eko; P = Prayas; D = Drishtee.

(+) "Plus" identifies the most important cost categories for each case.

The main cost observations are:

- Access to a strong distribution system is critical, as no one can afford to build a dedicated system from scratch: Prayas and Drishtee are leveraging systems they already developed, while Eko is building a network of *'kirana'* shops in the complementary business of mobile airtime.
- The technology-based 'self-service' model (e.g. in mainstream banking, the ATM) is not yet available. Service personnel are still needed to process transactions in every case. The cost per transaction remains significant.
- In the long term, the most relevant (variable) cost for both Eko and Drishtee is pay-out to their retail agents, typically a share of the commission received from the bank.
- Unlike the other models, Prayas delivers services directly through its staff, who also act as tellers in the NGO's offices. The result is a higher ratio of fixed to variable costs and a longer path to break-even.
- Balance-based models face potentially enormous client education costs to attract substantial savings.

RECOMMENDATIONS FOR BCs: CROSSING THE DOUBLE HURDLE

BCs and their agents must break even twice – first through sign-ups, and second through converting sign-ups into active users. After agents have signed up everyone they can in their service area, a very different skill-set, time horizon and marketing strategy are needed to hit the second stage of profitability. “A majority of No Frills accounts opened by BCs have remained non-operational. Retaining customers after the initial transactions proves to be a big challenge ⁶.”

Transaction-based BCs can achieve rapid sustainability by targeting clients who demand larger, one-time transactions like remittances, cheque deposits and time deposits. They must also discourage loss-making transactions like small deposits and withdrawals, and small recurring deposits. If recurring deposit limits are kept high, and time deposits actively marketed, losses from the former can be more than offset through profits in the latter. The willingness and ability of banks to accomplish system integration between their core banking system and the BC is another critical success factor.

Balance-based BCs require a longer investment horizon. Offering a wide range of useful financial products around the no-frills leader should impel a gradual rise in balances over time. Withdrawals and frequent small transactions must be discouraged. Moderately large recurring deposits (>Rs.150) have a major positive impact over time, especially if maturing ones can be retained/rolled over into time deposits.

In both models BCs can hit break-even faster through adding supplementary business lines with quick, profitable pay-back. For BCs with microcredit experience this is a natural add-on, since they have already incurred the cost of setting up and maintaining a viable distribution channel. The agent model can reduce the overall cost of delivery as agents can usually take on and manage more of the lending risks, and may require lower salaries than MFI staff. However, agents' activities are also subject to less direct control. The BC will be dependent on the agents' initiative for the pace of business growth, and dependent on their networks and business performance for portfolio quality.

⁶ Report of the Working Group to Review the Business Correspondent Model. Reserve Bank of India, Mumbai, Aug. 2009, p. 12.

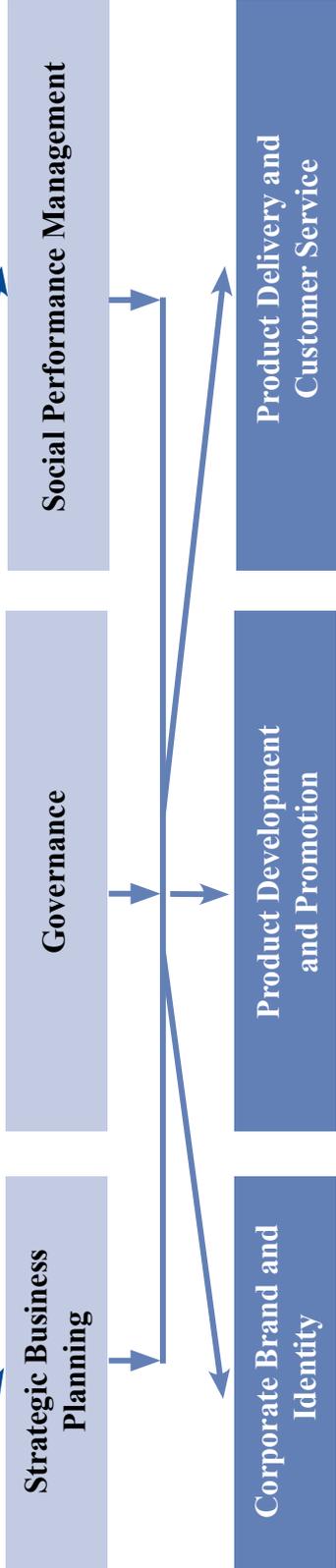
As volumes increase, banks may increase product complexity and mix transaction and balance-based incentives in their models. BCs should be careful to master one approach before focusing on the other, as the two approaches have very different institutional, control and marketing implications, and require different skill sets from staff and agents.

CONCLUSIONS

This study analyses three of the many experiences in branchless banking in India and attempts to reach general recommendations for making BC models sustainable.

In the long run, the incentives in balance-based models will greatly promote financial inclusion. However, these models are significantly more difficult and costly to manage than transaction-based ones. An evolutionary transition from a transaction-based approach to an integrated approach will be healthy for Indian microfinance.

INSTITUTIONAL DEVELOPMENT



Tier 1
Strategies

Tier 2
Strategies

- Market Research for Micro Finance
- Strategic Marketing for MFIs
- Product Marketing
- Corporate Brand and Identity
- Customer Services for Financial Institutions
- Process Mapping
- Capital Structuring & Equity Valuation

- Market Research for Micro Finance
- Quantitative Market Research Methods
- Costing and Pricing of Financial Services
- Process Mapping
- Institutional and Product Development
- Risk Analysis
- Individual Lending for Managers
- Individual Lending for Credit Officers
- Planning, Conducting and Monitoring
- Pilot Tests: Savings Products
- Planning, Conducting and Monitoring
- Pilot Tests: Loan Products
- Product Roll-Out

- Market Research for Micro Finance
- Customer Services for Financial Institutions
- Process Mapping
- Loan Portfolio Audit
- Internal Audit & Controls
- Financial and Accounting Systems
- Financial Management and Ratio Analysis
- Advanced Accounting for MFIs
- Management Information Systems for MFIs
- Delinquency Management for Group-based MFIs
- Human Resource Management
- Designing and Implementing Staff Incentive Schemes
- Training of Trainers
- Branch Managers' Training

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