DONOR BRIEF
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Helping to Improve Donor Effectiveness in Microfinance

SAVINGS ARE AS IMPORTANT AS CREDIT: DEPOSIT SERVICES FOR THE POOR

The poor save all the time. Savings are often the only way the poor can manage to pay for a major life event (such as a marriage or funeral), survive a natural disaster, or take advantage of a business opportunity.

How do poor people save?

The poor rarely have access to voluntary deposit services offered by formal or semi-formal institutions. Instead, they are obliged to save informally: they invest in livestock, hide cash at home, have their savings collected by neighbors, or participate in rotating savings and credit associations. In many cases, these informal savings are high risk, illiquid, indivisible or impose uniform terms. A cow, for example, can die of disease and must be sold as a whole, not in parts, to obtain cash. And the transaction imposes time and financial costs.

Are savings more important than credit?

Credit often serves the same purposes as savings for the poor, but it is riskier, usually more expensive, and often as unavailable as appropriate deposit services. The poor often prefer to save and are even willing to pay to do so. Savings may in fact be more important than credit in helping the poor to raise incomes and reduce risk. It can be argued, however, that the income impact may take longer to realize with savings.

What do the poor want from deposit services?

Typically, the poor want their savings to be secure, with low transaction costs, appropriate design, and, if possible, constant in value. Their priorities in order of preference are:

- **Security:** Secure savings are not in jeopardy from fraud, theft, fire, and relatives' demands. Safety is paramount, even in the face of inflation.
- **Low transaction costs:** Proximity is essential to reduce the high transaction costs of making deposits and withdrawals. Convenient opening times and minimal paperwork are also important.
- **Appropriate design:** Individual voluntary deposit products that allow frequent deposits of small, variable amounts and quick access to funds are best. Contractual savings are also useful for planned future lifecycle expenditures such as weddings, funerals, and birth celebrations.
- **Interest rates:** If transaction costs are low, rural savings takes place even with negative real returns – indicating that the poor can be relatively insensitive to interest rates as a priority when evaluating savings options. Nevertheless, demand for savings products does increase as real interest rates rise.

What institutions can provide deposit services?

An institution providing deposit services for the poor needs the capacity for 'safe and sound' deposit operations. This requires strong management of credit, liquidity, and interest rate risk. It also requires internal controls; management information systems; the financial capacity to withstand external shocks (e.g., inflation and devaluation); and adequate capital. Institutions that collect deposits from the public should be properly supervised, but not all will require the same type of formal central bank supervision. A combination of strategies should tailor accountability requirements to the scale of the deposit institution. Finally, institutions should be committed to expanding access to greater numbers of the poor.

Consultative Group to Assist the Poorest 1818 H Street, NW Washington, DC 20433
Tel: 202 473 9594 Fax: 202 522 3744 E-mail: cgap@worldbank.org Web: www.cgap.org

- **Commercial and government-controlled banks** offer the greatest potential for security and scale of outreach. However, they often need technical assistance to develop appropriate products for the poor. They can also require fundamental changes in governance and management. Successful examples include BRI in Indonesia and Banco do Nordeste in Brazil.
- Most **non-governmental organizations (NGOs)** lack the governance, legal status and institutional capacity to intermediate voluntary deposits from the public. However, they may be less risky than alternatives in the informal sector, as the record of several MFIs in Bangladesh demonstrates.
- **Specialized microfinance banks and non-bank financial institutions** may be better suited than most non-specialized banks to reach small depositors on a viable basis (where regulations permit), but typically they do not have large-scale existing infrastructure.
- **Financial cooperatives (i.e. credit unions or savings and credit cooperatives)** are already significant and often sustainable providers of deposit services, particularly in West Africa.
- The low cost structure of **self-managed, semi-formal groups** (e.g., self-help groups, autonomous village banks) may enable them to serve more remote depositors than other institutions. Yet the savings products of such groups are neither flexible nor easy to replicate within formal financial institutions.

What do donors need to know about supporting savings services?

In supporting savings services, donors assume *de facto* responsibility for assuring the poor that their deposits are secure. Therefore, donors should only support deposit mobilization if they have the in-house expertise to identify appropriate partner institutions (particularly large regulated banks); a long time horizon; and a tolerance for high-risk but potentially high-return projects. Savings projects may require many years of ongoing technical support without the guarantee of success.

Strategies for donor support

- **Avoid big credits lines**, invest instead in long-term technical assistance.
- **Fund capacity building** of both government and nongovernmental regulatory and supervisory bodies. This includes coordinating discussions with governments and central banks about policies, laws, and regulations needed to facilitate the mobilization of small deposits and to protect small savers.
- **Fund research and development** of savings products and delivery innovations.
- **Undertake information dissemination** to commercial banks and other regulated retail organizations with large branch networks. Banks need to understand that financing portfolios through deposit mobilization from the poor can be profitable. Donors and banking institutes need information on good practice.
- **Finance initial physical infrastructure and operating losses for a limited time for retail institutions**, based on performance. Disbursements should be linked to the attainment of clear performance targets.
- **Fund institutional development for organizations** that act as liquidity pools, alternative supervisory bodies, training institutions, and second-tier institutions that provide technical support.
- **Avoid subsidized loans for funding portfolios**. If a loan instrument cannot be avoided, the loan should be priced at the cost of mobilizing deposits.

An example of good donor practice can be seen in a recent GTZ project in Thailand. In a relatively small investment, GtZ funded one international and one local expert for two years at the Bank for Agriculture and Agricultural Cooperatives. A microsavings product was designed, piloted, and launched in March 1996. Six years later, the Bank has 2.2 million microsavers who have collectively saved 207 million Euros!

This Donor Brief is based on Madeline Hirschland, *Developing Deposit Services for the Poor: Preliminary Guidance for Donors,* CG Working Paper on Savings, April 2002 revision. It also draws on "Savings Mobilization Strategies: Lessons Learned from Four Experiences," CGAP Focus Note No. 13 (August 1998).

Where to go for more information. Books: Rutherford, Stuart. *The Poor and Their Money.* New Delhi: Oxford University Press, 2000. Robinson, Marguerite. *The Microfinance Revolution,* "Chapter 7: Savings & the New Microfinance" (Wash., DC: World Bank, 2001). ***Websites:*** *www.microsave-africa.com; http://www.gtz.de/fsd/products/saving_mobilization_details.htm* - case studies published by GTZ.

CGAP Donor Team: Brigit Helms - bhelms@worldbank.org
Alexia Latortue - alatortue@worldbank.org Natasa Goronja – ngoronja@worldbank.org