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FocusNote

NO. 37 SEPTEMBER 2006

SAFE AND ACCESSIBLE: BRINGING POOR SAVERS INTO THE FORMAL FINANCIAL SYSTEM

The author of this Focus Note is Rani Deshpande, a microfinance specialist at CGAP.
The author thanks Brigit Helms for her guidance in writing this note; Rich Rosenberg, Ousa Sananikone, Jeanette Thomas, and Elizabeth Littlefield for their comments; and Mark Pickens and Jasmina Glisovic-Mezieres for their editorial and research assistance.

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Despite significant evidence to the contrary, many financial institution managers and policy makers do not believe poor people save money. They tend to assume that poor people are "too poor to save," that they prefer to consume rather than save excess income, or that when they do save it is only to access a loan.[1]

The numbers, however, paint a different picture. Research has repeatedly demonstrated that saving is central to poor people's economic management strategies. Projects such as the Financial Diaries initiatives in India, Bangladesh, and South Africa; MicroSave in eastern and western Africa; and studies by the International Food Policy Research Institute, for example, have documented savings practices among the poor.[2]

What *is* unclear is how well formal financial institutions satisfy poor savers' needs. Although over 90 percent of adults in industrialized economies typically have accounts in financial institutions, market studies in some areas of the developing world indicate penetration rates as low as 6 percent. Access to savings services for the poor thus varies widely.

Understanding this variation and its root causes is the primary goal of CGAP's Country-Level Savings Assessments (see Box 1). The assessments explore opportunities and constraints encountered by formal institutions in meeting demand for deposit services among the poor.[3] This Focus Note summarizes the findings from Country-Level Savings Assessments in Benin, Bosnia, Mexico, the Philippines, and Uganda, which suggest five strategies for improving poor people's access to savings services.

Although these five countries were chosen for the assessments, in part, because of their diversity, the findings of the assessments are strikingly similar in many ways. All five assessments found high demand for savings services but low usage of formal financial institutions, which lag behind informal savings mechanisms in fulfilling key client preferences.

Institutional capacity and incentives are the primary factors behind the inability of formal financial institutions to compete with informal savings approaches. However, supportive industry infrastructure and policy frameworks also play important roles.

[1] Interviews conducted as part of CGAP's five Country-Level Savings Assessments, where review teams met with over 300 individuals knowledgeable about the financial system, indicate that these beliefs are widespread.

[2] For more information on these findings see Rutherford 2003, Ruthven and Kumar 2002, the Financial Diaries Web site (www.financialdiaries.com), and Zeller and Sharma 2000.

[3] Formal institutions are defined as those registered with the government. Generally, these include banks of all kinds; nonbank financial intermediaries, including microfinance institutions; and cooperatives licensed to take deposits. When not regulated or supervised, the latter are sometimes referred to as semi-formal.

Box 1 Country-Level Savings Assessments: Purpose and Method

CGAP's Country-Level Savings Assessment methodology examines the obstacles and opportunities for improving small deposit mobilization in a particular market, and helps identify strategies to address them. Savings Assessments can be used as an input into design of particular programs or policies, or commissioned by groups of stakeholders to build industry-wide dialogue on the subject. For more information on the assessments, go to www.cgap.org/savings.

Improving small deposit services, therefore, requires work at all levels of the financial system.

Low Usage Does Not Mean Low Demand

The prevailing perception that poor people do not save may stem from the low penetration of formal savings mechanisms, the most common of which are accounts in financial institutions. In Mexico, recent studies estimate that less than 25 percent of the urban population, and as little as 6 percent of the rural population, has any kind of account in a financial institution (World Bank 2005 and World Bank 2001). In the Philippines, only 12 percent of survey respondents in small cities kept money in a bank (Micro-Enterprise Bank and Karlan, Ashraf, and Wesley 2004). And in Uganda, only 10 percent of rural residents report using a financial institution (Wright and Rippey 2003 and Pelrin and Kabatalya 2005). Thus, low penetration rates of financial institutions are evident regardless of urban or rural distinctions.

Evidence suggests an enormous market for deposit services among poor clients. In a few markets, surveys have documented this demand. In Bosnia, for example, Gallup International (2003) found that almost 40 percent of survey respondents indicated that they wanted, but did not have, a bank account (see Figure 1). In a survey of Mexico City residents, demand for interest-bearing accounts was almost unanimous among the unbanked (World Bank 2003).

Because such market data are rare in low-income countries, demand often must be inferred in other ways. One indication of demand is the rapid growth in deposits among institutions that have consciously targeted small deposits, a phenomenon observed in market after market. In Benin, the microfinance institution PAPME introduced voluntary savings products in 2000 and saw deposits increase over 20 times in five years even without an active marketing campaign. In Mindanao, the poorest region of Philippines, One Network Bank acquired 23,150 new depositors in three months by actively promoting an image of stability and good management to rural clients. And in Bosnia, ProCredit Bank doubled deposits in one year simply by improving staff knowledge of available savings products.

Another indicator of demand for deposit services is the extent of informal savings. A survey of rural Ugandans indicates that 89 percent save in cash, in kind, or in informal savings groups (as opposed to only 12 percent who save in formal or semi-formal financial institutions) (Pelrine and Kabatalya 2005). Even employees of financial institutions are reported

Figure 1 Demand for bank accounts among Bosnian survey respondents

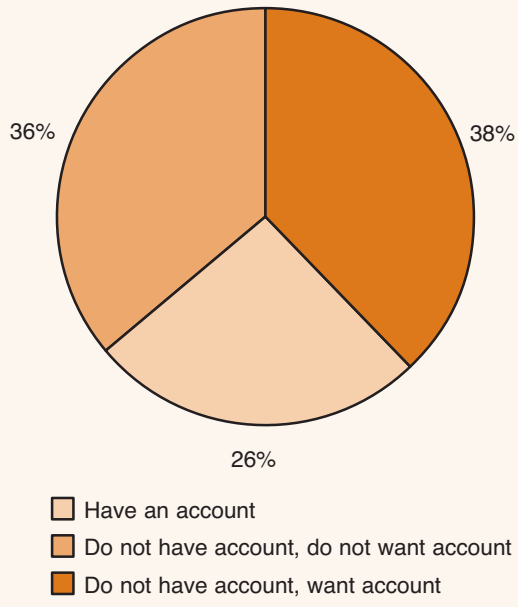


Table 1 Use of formal and informal savings mechanisms in Mexico (Percentage of respondents using respective mechanisms)

	Formal financial (represented by banks)	Informal financial (Represented by tandas)	Physical assets (Grains, animals, construction materials)
TOTAL	27	20	29
Income level			
Very Low	10	11	42
Low	22	19	32
Medium	29	30	23
Medium-high	53	23	24
High	67	22	17

Source: Bolaño, Pilar Campos. 2005. *El Ahorro Popular en México: Acumulando Activos para Superar la Pobreza.* CIDAC and Miguel Angel Por-

to operate their own rotating savings and credit associations among staff.

In the Philippines, one study suggests that two-thirds of people in smaller urban cities keep their savings at home (Karlan, Ashraf, and Wesley 2004). Informal savings are also widespread in Mexico, where another survey shows that 50 percent of rural residents keep money at home. Respondents also reported keeping over 90 percent of their savings in cash or in kind and less than 10 percent on deposit in a financial institution (World Bank 2001). In Mexico City, 28 percent of the unbanked and 40 percent of the banked hold some financial savings outside of financial institutions (World Bank 2003). Nationwide in Mexico, the level of usage of informal instruments increases as education and income levels decrease (see Table 1).

Perhaps the most compelling evidence of demand for deposit services comes from West Africa, where clients routinely pay roving deposit collectors to hold their money. Just as the existence of moneylenders indicates a demand for credit among the poor, the widespread use of informal savings mechanisms may signal demand for formal deposit services. But to tap that demand, formal services must offer clients a more attractive value proposition than what they already can access informally. Whether or not they can do so—at least with current service delivery models—is an open question.

How do formal savings services compete with the informal sector?

To compete with informal savings mechanisms, formal services must be appropriate for poor savers, satisfing key client preferences. Although these preferences vary from market to market, worldwide, low-income savers tend to care most about accessibility and security. Accessibility can be seen as physical accessibility (proximity) and financial accessibility (affordability). Accessibility also can be defined as liquidity, although studies indicate that poor clients have both liquidity and illiquidity preferences (see Box 2).

When formal and informal savings mechanisms are compared on the key criteria of security, proximity,

Box 2 Don't poor people want liquidity?

Liquidity is often considered another key facet of accessibility and a priority for poor savers. Although this may be true for a certain set of clients—or a certain portion of most clients' overall economic portfolios—market studies demonstrate demand for a range of maturities.

For example, a study in Mexico found that a wide range of maturities is among the top three product features demanded by rural savers (World Bank 2001). A nationwide survey in Uganda found clients prefer making withdrawals monthly or quarterly, but they want to make deposits more frequently, suggesting a preference for illiquidity (Pelrine and Kabatalya 2005). This may be related to the reasons for which clients saved, which were skewed heavily in favor of school fees and medical expenses. These were also the top two savings goals in a study of urban low-income Filipinos.

and affordability, the reasons behind low usage of formal services are clear.

Proximity

Informal mechanisms out compete formal financial institutions when it comes to both dimensions of accessibility. In terms of proximity, it is hard to beat saving at home: cash stuffed into a mattress (or a bamboo post in one's house, as is done in the Philippines) is always accessible and carries no extra costs to the saver in terms of time or travel.

By contrast, formal deposit-taking institutions can be very far away indeed. Because precise average distances are difficult to calculate, the Savings Assessments used comparisons of branches, population, and surface area as rough proxies. Figures 2a, 2b, and 2c illustrate the average number of branches per population and square kilometer,

Figure 2a Branches per million inhabitants (regulated deposit-taking institutions)

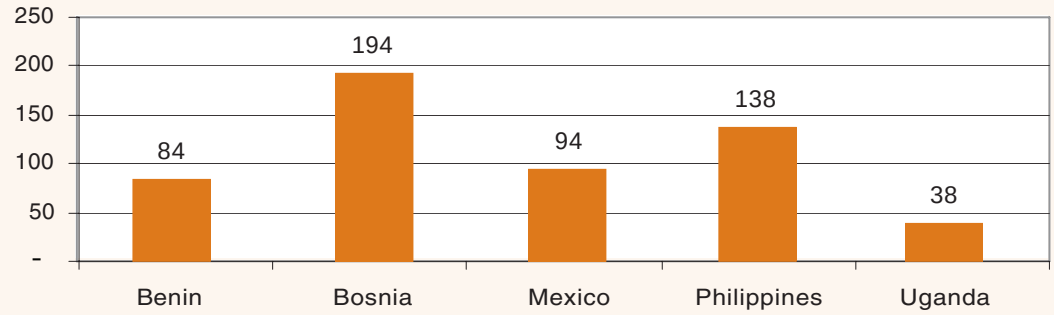


Figure 2b Branches per square kilometer (regulated deposit-taking institutions)

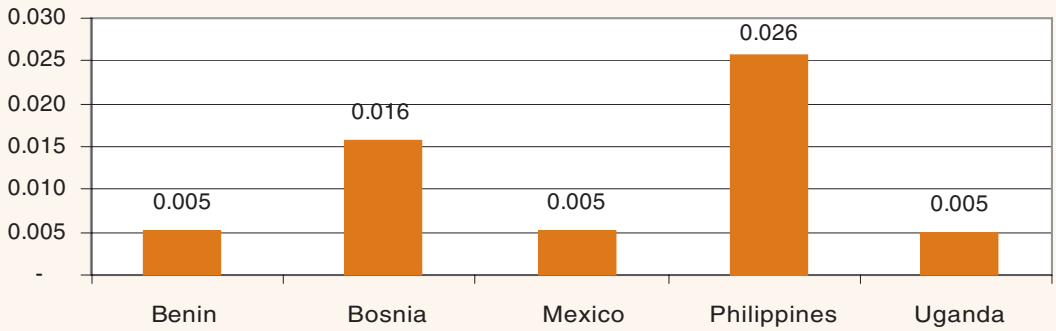
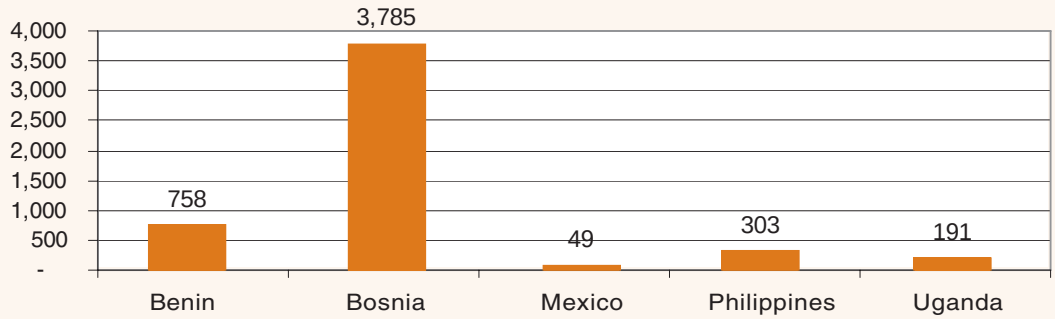


Figure 2c Branches/population/square kilometer (regulated deposit-taking institutions)



separately and combined, across the countries studied. The tremendous variation in these numbers shows little correlation to income level, with both Mexico (annual per capita GNI of almost $7000) and Benin (annual per capita GNI under $300) scoring similarly.

Within countries, however, CGAP found a much stronger relationship between income level and the distribution of deposit-taking institutions. In the Philippines, the correlation between the number of subsistence poor and the number of people per branch of deposit-taking institutions in different regions was 0.68. In Mexico, the correlation between the number of people per branch and the level of marginalization in different states was 0.62.[4]

Figures 3a and 3b illustrate this disparity in greater detail. (See pages 6 and 7.) In parts of Mexico City, for example, population per branch is less than 3,000. However, in certain districts of Chiapas (Mexico's poorest state), this ratio exceeds 100,000. Several districts have no branches of deposit-taking institutions at all. Similar situations were observed in Benin, Bosnia, the Philippines, and Uganda; maps showing the distribution of branches for deposit-taking institutions in these countries are available in the Country-Level Savings Assessment section of the Savings Information Resource Center (www.cgap.org/savings).

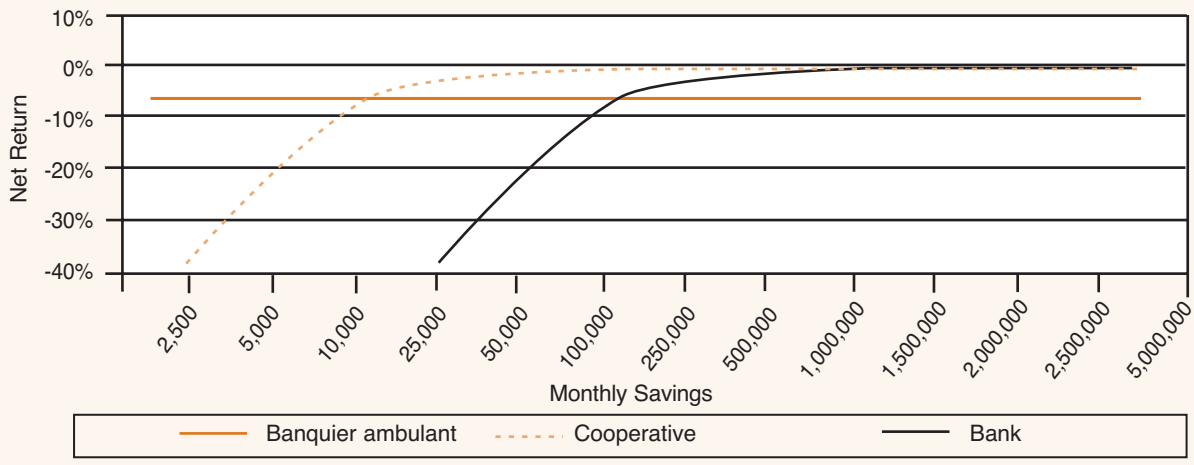
Affordability

Informal savings also tend to trump formal institutions in terms of price—even when they carry an explicit cost, as in the case of deposit collectors in West Africa. Typically, deposit collectors visit each client daily and collect a fixed amount, deducting one day's deposit at the end of the month as their service fee. On an average-balance basis, this amounts to a negative interest rate of 7 percent.

Although this fee seems steep, for most clients, it is still a better deal than using either local cooperatives or banks. The travel cost to use either formal institution generally outweighs the interest rate advantage, even without factoring in the value of the client's time. Figure 4 illustrates that a typical small-town resident of Benin would have to save more than 10,000 FCFA (USD 20) per month before using a cooperative made more financial sense than using a deposit collector. To make saving in a bank worthwhile, the client would have to save approximately 100,000 FCFA (USD 200) per month.

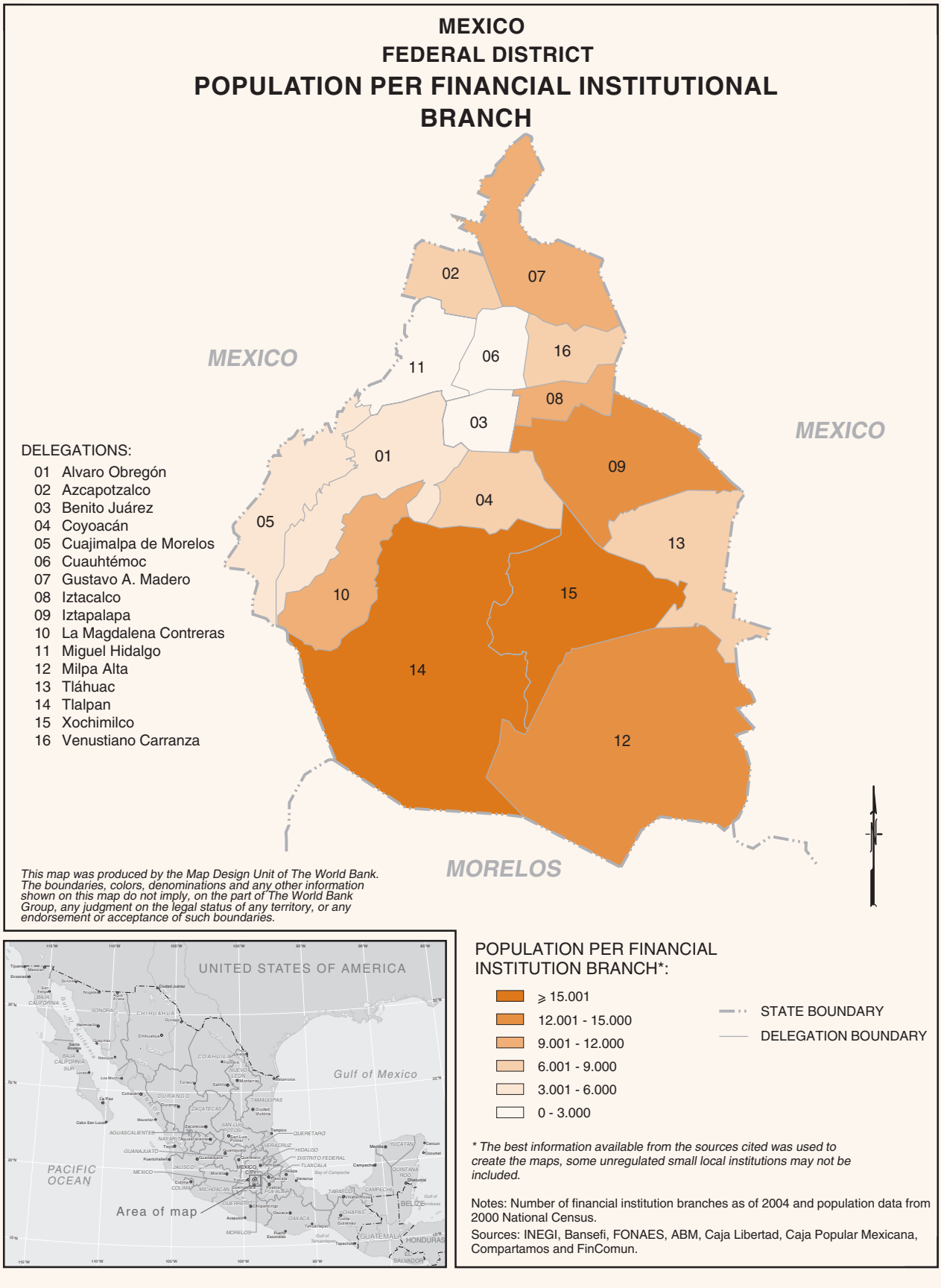
[4] Marginalization was measured according to a composite indicator established by the government.

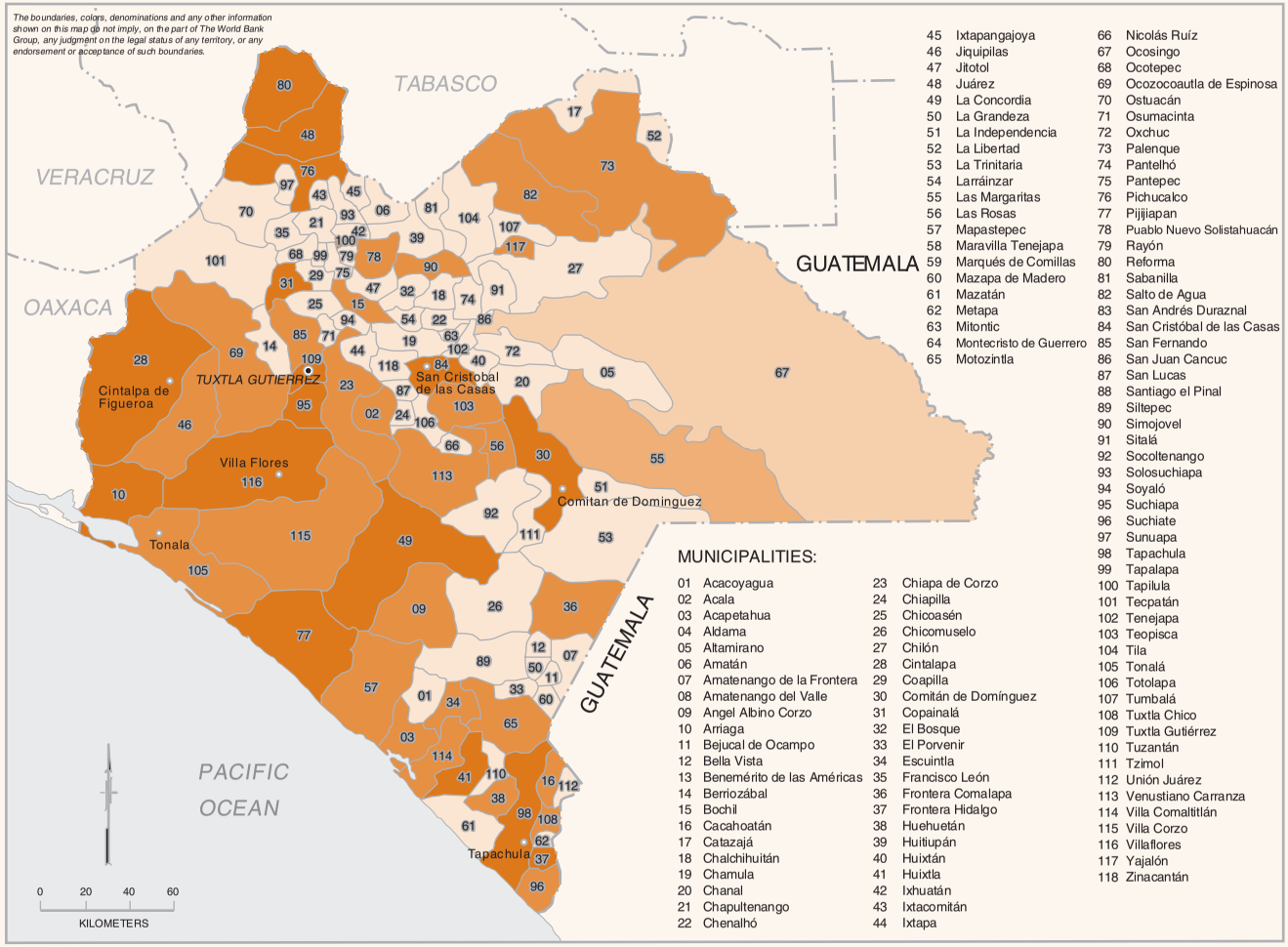
Figure 4 Net return on savings by mechanism (Benin)



Note: Calculations are based on costs faced by resident of typical small town in Benin. Assumptions: (1) *Banquier ambulant* (deposit collector) collects 30 deposits per month for a fee equal to 1 daily deposit; (2) client makes weekly trips to local cooperative at a per trip cost of 150 FCFA, cooperative pays no interest; (3) client makes monthly trips to the bank at a per trip cost of 5000 FCFA, bank pays 3.5% annual interest. See Helms, et al. 2005.

Figure 3a Mexico penetration map





MUNICIPALITIES:

01 Acacoyagua
02 Acala
03 Acapetahua
04 Aldama
05 Altamirano
06 Amatán
07 Amatenango de la Frontera
08 Amatenango del Valle
09 Angel Albino Corzo
10 Arriaga
11 Bejucal de Ocampo
12 Bella Vista
13 Benemérito de las Américas
14 Berriozábal
15 Bochil
16 Cacahoatán
17 Catazajá
18 Chalchihuitán
19 Chamula
20 Chanal
21 Chapultenango
22 Chenalhó
23 Chiapa de Corzo
24 Chiapilla
25 Chicoasén
26 Chicomuselo
27 Chilón
28 Cintalapa
29 Coapilla
30 Comitán de Domínguez
31 Copainalá
32 El Bosque
33 El Porvenir
34 Escuintla
35 Francisco León
36 Frontera Comalapa
37 Frontera Hidalgo
38 Huehuetán
39 Huitiupán
40 Huixtán
41 Huixtla
42 Ixhuatán
43 Ixtacomitán
44 Ixtapa
45 Ixtapangajoya
46 Jiquipilas
47 Jitotol
48 Juárez
49 La Concordia
50 La Grandeza
51 La Independencia
52 La Libertad
53 La Trinitaria
54 Larráinzar
55 Las Margaritas
56 Las Rosas
57 Mapastepec
58 Maravilla Tenejapa
59 Marqués de Comillas
60 Mazapa de Madero
61 Mazatán
62 Metapa
63 Mitontic
64 Montecristo de Guerrero
65 Motozintla
66 Nicolás Ruíz
67 Ocosingo
68 Ocotepec
69 Ocozocoautla de Espinosa
70 Ostuacán
71 Osumacinta
72 Oxchuc
73 Palenque
74 Pantelhó
75 Pantepec
76 Pichucalco
77 Pijijiapan
78 Puablo Nuevo Solistahuacán
79 Rayón
80 Reforma
81 Sabanilla
82 Salto de Agua
83 San Andrés Duraznal
84 San Cristóbal de las Casas
85 San Fernando
86 San Juan Cancuc
87 San Lucas
88 Santiago el Pinal
89 Siltepec
90 Simojovel
91 Sitalá
92 Socoltenango
93 Solosuchiapa
94 Soyaló
95 Suchiapa
96 Suchiate
97 Sunuapa
98 Tapachula
99 Tapalapa
100 Tapilula
101 Tecpatán
102 Tenejapa
103 Teopisca
104 Tila
105 Tonalá
106 Totolapa
107 Tumbalá
108 Tuxtla Chico
109 Tuxtla Gutiérrez
110 Tuzantán
111 Tzimol
112 Unión Juárez
113 Venustiano Carranza
114 Villa Comaltitlán
115 Villa Corzo
116 Villaflores
117 Yajalón
118 Zinacantán

MEXICO
STATE OF CHIAPAS
POPULATION PER FINANCIAL INSTITUTIONAL BRANCH

POPULATION PER FINANCIAL INSTITUTION BRANCH*:
NO FINANCIAL INSTITUTION BRANCHES
≥ 100.001
50.001 - 100.000
20.001 - 50.000
1 - 20.000
STATE CAPITAL
SELECTED CITIES
MUNICIPAL BOUNDARIES
STATE BOUNDARIES
INTERNATIONAL BOUNDARIES

** The best information available from the sources cited was used to create the maps, some unregulated small local institutions may not be included.*

Notes: Number of financial institution branches as of 2004 and population data from 2000 National Census.

Sources: INEGI, Bansefi, FONAES, ABM, Caja Libertad, Caja Popular Mexicana, Compartamos and FinComun.

Figure 3b Mexico penetration map

These minimum amounts are equivalent to 12 days and 120 days, respectively, of minimum wage in Benin. Given that many people in Benin earn far less than the minimum wage, formal savings services are beyond the reach of many poor people.

Formal financial institutions tended to price themselves out of the market for poor people's savings across the markets studied by CGAP. The "threshold costs" of basic deposit products—i.e., the amount of money needed for opening fees, minimum balances, and shares, in the case of cooperatives—were often many times what poor people could afford. This was especially true in safer, regulated institutions, such as banks.

In CGAP's analysis, "basic deposit products" were defined as the lowest-cost savings or transaction account in a given institution. Because of minimum balance requirements for other products, these demand deposit or current accounts are often the first or only type of account poor clients can afford.

CGAP's research found that threshold costs tend to decrease as branch density (the number of branches per population) increases. Across the countries studied, the correlation between threshold costs (measured as a multiple of minimum wage) and population per branch was -0.78 for all deposit-taking institutions. The correlation was stronger (-0.83) when only bank branches were considered (see Appendix 2). Although based on a limited sample of countries, the results support the expectation that competition brings down price.

Security

Although informal options have advantages over financial institutions based on proximity and affordability, comparisons between informal and formal options based on security are less conclusive. Deposit collectors are rarely subject to regulation or supervision, and reports of them absconding with client savings are common. Saving at home carries its own risks, such as theft or loss from fire or flood. But banks also fail. In fact, every one of the markets studied by CGAP had suffered a banking system crisis in the past 10–20 years—well within the memory of the current generation of savers, with the expected impact on client confidence. Still, the most thorough study of security in informal savings to date indicates that informal mechanisms are far riskier than even unsupervised deposit-taking institutions (Wright and Mutesasira 2002).

Ironically, security often emerges as savers' top priority in surveys of low-income clients. Why, then, do poor clients seem to prefer informal to formal savings? Behavioral finance suggests that familiar risks or those perceived to be under an individual's control tend to be underestimated compared with risks that are unfamiliar or perceived to be not within a person's control (Hertwig et al. 2004). The risk inherent in saving at home, with a trusted deposit collector, or in livestock that one has been tending since childhood, may thus be underestimated compared with the risk of saving in an unfamiliar institution with opaque management. Because important measures of security in a formal institution—such as loan losses—are not directly observable, it is easy for clients to misjudge the relative security of informal versus formal savings options. Given the widespread absence of systems to signal institutional soundness, comparing the security of different formal institutions is also a challenge for customers.

Trade-offs between security and accessibility

Often, financial institutions that are most accessible to poor clients—especially in rural areas—are less secure (in terms of financial soundness and therefore risk to savings) than institutions that target wealthier clientele. In the Philippines, for example, rural banks have higher nonperforming loan ratios than either thrift or commercial banks. In Uganda, the average reported portfolio at risk (PAR) greater than 30 days in savings and credit cooperatives (SACCOs) reach as high as 42 percent, compared with single digits for regulated institutions.[5] However, these regulated institutions are seldom located outside primary and secondary cities.

[5] PAR 30 equals the outstanding balance of loans with any payment more than 30 days late, divided by the outstanding balance of all loans.

Reliable data are seldom available for institutions serving the poor. In Uganda, PAR data are available for only 147 SACCOs out of an estimated total of 750–900 currently active in the country. In the Philippines, even the total number of financial cooperatives in operation is unknown. The only performance data available come from a small number of co-ops selected for a donor-funded technical assistance project because of their promise for improvement. At the time of entry into this project in 1997, their collective PAR 30 was 54.6 percent (although by 2005 this had declined to 8.76 percent).

No single type of deposit-taking institution generally offers low-income clients security, proximity, *and* affordability. Therefore, clients tend to use savings instruments whose advantages they can see and that they can access. Proximity and affordability—features offered par excellence by informal mechanisms—are clearly visible to clients. Lack of security is not. Poor savers may thus be sacrificing what they most value in a deposit service—security—by using informal mechanisms that provide clear evidence of proximity and affordability but do not necessarily provide security. Conversely, formal institutions that offer secure savings opportunities have difficulty penetrating the savings market for poor clients because they tend to be inaccessible to poor clients.

Why Can't Formal Institutions Compete?

Why do so few formal financial institutions offer both security and access to poor savers? CGAP's Savings Assessments have identified a constellation of causes at three levels of the financial system.

Inadequate management capacity and high cost structure

The skills needed to manage savings programs are different, and often more sophisticated, than those needed to run credit programs. Capable management, staff, and systems are crucial for mobilizing savings. But high-capacity management often carries a high price tag, and institutions that operate in poor and rural areas usually need to maintain a low cost structure.

To be able to afford high-capacity management, institutions, such as cooperatives, need to achieve economies of scale. Some institutions achieve economies of scale by consolidating and becoming branches of a single "mother cooperative." The consolidation of 60 independent cooperatives to become Caja Popular Mexicana is an example of a successful transformation. Between 2001 and 2005, Caja Popular Mexicana saw capital adequacy increase by three times, operating expenses halved, delinquency fall by two-thirds, and assets and membership double. However, this transformation took some 15 years of work by the consolidating credit unions and $4 million in donor funds for skilled, credible technical assistance providers.

Institutions that already have the capacity to safely manage deposits need to focus on lowering delivery costs to be able to serve low-income markets. Advancements in technology have made industry professionals enthusiastic about the potential of developing technology-enabled channels to lower costs for delivering services, including deposits. Unfortunately, this type of cost-cutting itself may require substantial up-front investment.

In Uganda, one micro-deposit-taking institution estimates that it has invested $200,000 in developing a system using smart cards and point-of-sale terminals (in addition to considerable investment by public and private donors). Despite this investment, the new system has yet to be rolled out at scale.

Another strategy increasingly used by banks to lower service delivery costs is to take advantage of retail infrastructure that is already in place. In Mexico, one bank established mini-branches inside a network of appliance stores and was able to open 4 million savings accounts in two years—more accounts than the entire "popular finance" sector, with comparable average balances.[6]

[6] The "popular finance" or *finanzas populares* sector in Mexico refers to institutions, such as MFIs and cooperatives, that serve the traditionally unbanked.

In the Philippines, Banco de Oro enables cashiers at a major retailer to act as service points for the bank's main mass-market product, a reloadable payroll and debit card. In two years, this product mobilized $5.6 million in balances on 700,000 cards in force (in a country with a working population of about 50 million). In both the Mexican and Filipino cases, the bank and cooperating retailer are owned by the same parent company.

Few outlets for excess liquidity

Excess liquidity in financial institutions limits incentives to mobilize additional deposits—especially poor people's deposits, which tend to be perceived *a priori* as short term, unstable, and costly. Unfortunately, regulated financial institutions in many markets already have more than enough deposits relative to lending or investment opportunities, especially in the short term. At the time of the Philippines CGAP assessment, for example, savings in banks were 150 percent of bank loans to the private sector. In Benin, the proportion was roughly similar. In Bosnia, although the banking system was slightly under-liquid overall, excess liquidity was concentrated in the short term (under one year), with 60 percent of deposits against only 25 percent of loans.[7]

At the institutional level, excess liquidity may be caused by a lack of suitable lending opportunities (real or perceived). Especially among banks, demand for on-lending funds can be limited, particularly in countries where government debt is not an attractive investment opportunity.

Although particular institutions may be temporarily under- or over-liquid, in developed countries these imbalances are usually corrected by liquidity management mechanisms. However, many developing-country markets lack these liquidity management mechanisms. Even Bosnia, which is, by some measures, the most advanced financial system studied by CGAP, lacks overnight markets, repurchase agreements, and other tools commonly used by banks to manage liquidity.[8]

Lack of liquidity management mechanisms was especially common among cooperatives, perhaps because of the fear of spreading risk from badly managed to well-managed co-ops. The disincentive to savings mobilization posed by excess liquidity in cooperatives can be especially damaging for poor clients, because co-ops tend to be more accessible than other types of institutions. Better liquidity management tools would make deposits more attractive.

In Uganda, stakeholders are considering ways to place excess co-op liquidity in regulated institutions that offer safe, remunerative investments—or directly into Ugandan government bonds, which offer attractive rates. Either option is less risky than encouraging these cooperatives to ramp up lending (especially uncollateralized lending like microcredit) in light of their high loan delinquency rates.

Unfair competition from "cheap and easy" wholesale funds

Unfortunately, deposit mobilization often is discouraged by wholesale financing from apexes (usually government owned). In countries as diverse as Uganda and the Philippines, donors and governments provide millions of dollars in wholesale financing to deposit-taking institutions that are among the most accessible to poor clients (SACCOs in Uganda and rural banks in the Philippines).

Second-tier financing in both Uganda and the Philippines is at near-market rates, so the funds are not as cheap as they could be. Still, relatively easy access to wholesale funds has served as a disincentive for financial institutions to pursue additional deposits to finance portfolio growth. If these funds were crowding out deposits in shaky institutions, this might be considered a benefit to savers. However,

[7] Nor were excess funds being soaked up by treasury bonds. In the Philippines, these were returning around the same rate as inflation; in Benin, government bond issues were extremely uncommon; and in Bosnia, the government is currently prohibited from issuing sovereign debt.

[8] Foreign-owned banks in Bosnia can alleviate excess short-term liquidity by sending short-term deposits abroad to their parent banks in return for longer-term lines of credit. But most financial institutions do not have this option.

the logic of wholesale funders leads them to channel funds to the strongest, not the weakest, institutions. Incentives are therefore dampened for the very institutions best able to safeguard client deposits.

A common rationale for second-tier credit lines is the mismatch that sometimes exists between financial institution over-liquidity in the short term and under-liquidity in the longer term. But often, short-term funds are much more stable than commonly thought and could be used for longer-term lending. Occasionally, regulation also can underestimate the stability of short-term deposits: in Bosnia, 95 percent of deposits under 30 days must be lent out for the same term—a very limited market in a country with no overnight interbank lending.

Incomplete payment systems

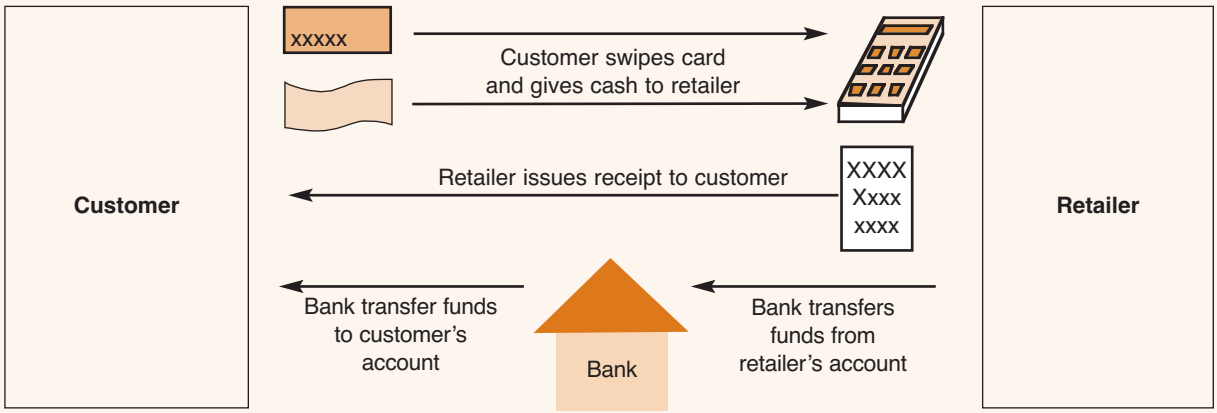
Access to the payment system can greatly affect an institution's ability to capture deposits. Traditionally, access to the payment system is restricted to more highly regulated institutions and often requires a hefty security deposit with the payments clearinghouse. Payment systems are, in fact, often owned by large banks. These attributes tend to put access to payments systems beyond the reach of small financial institutions that cater to the poor. The inability of these institutions to make clients' savings accessible in multiple locations or to provide payments services makes depositing with them less attractive.

However, a new breed of payments provider promises to make payment services more widely available. Some of these providers use mobile phones linked to bank accounts for domestic and international money transfers, purchases, loan repayments, and cash withdrawals. Often these transactions involve a debit card and a network of point-of-sale devices located in financial institutions and retail establishments (see Box 3) (Ivatury 2006).

Box 3 Bypassing the payments system

Banks are increasingly teaming up with retailers and mobile phone providers to offer financial services, including payments and deposits, to poor customers. In Brazil, six banks have built a network of over 26,000 banking correspondents: merchants equipped with card-reading devices that customers can use to open accounts and make transactions.

To make a deposit, customers identify themselves by swiping their card and giving cash to the retailer. The bank transfers the corresponding amount from the retailer's account to the customer's account. The clerk keeps the cash received in the till and issues a receipt to the customer (see diagram below). Largely because of the increase in banking correspondents, by the end of 2003, banking services were available in all of Brazil's more than 5,600 municipalities.



Similar services are being introduced elsewhere. In the Philippines, Globe Telecom offers G-Cash, a service that lets subscribers load cash onto their mobile phones via affiliated merchants or Globe outlets, and then use it to make international or domestic money transfers, pay bills, or make purchases. The service is usually operated like a "virtual wallet," with no bank involved. However, Globe is partnering with a growing number of rural banks to enable clients to receive and repay loans via G-Cash. Mobile phone banking also is making inroads in South Africa, where a joint venture between Standard Bank and mobile phone provider MTN has acquired more than 100,000 customers since 2004.

Uneven regulation and supervision

Regulation and supervision, which can be highly restrictive for some types of institutions and loose or nonexistent for others, can perpetuate a situation where safe institutions have few incentives to pursue poor depositors, and accessible institutions cannot guarantee the safety of deposits.

Postal banks are a case in point. In many markets, they maintain some of the most extensive networks of service points for deposit taking, and they offer payment services. However, many postal banks are not subject to banking regulation. Because they are considered part of the postal service, their assets are at risk of leakage into loss-making postal systems. This is the case with Caisse Nationale d'Epargne, the postal savings bank in Benin that is in the process of separating from the postal service.

Policy frameworks are often inappropriate for financial cooperatives as well. In Uganda, for example, SACCOs are not governed by dedicated legislation. They operate under a variety of legal regimes, including the Cooperatives, Companies, and NGO Acts. In many countries, they are not monitored by appropriate financial regulators, but rather by agencies in charge of all cooperatives. In Uganda, this is the Ministry of Tourism, Trade, and Industry, which is widely acknowledged to lack the capacity to supervise the 1400 SACCOs currently registered.

Where a dedicated agency for cooperatives does exist, as in the Philippines, that agency typically is charged with promoting cooperatives as well as monitoring them, resulting in a conflict of interest that can weaken the supervisory function. Delegating supervision to membership-based federations also can produce a conflict of interest, because member institutions may seek to leave the federation to avoid strict supervision. In Mexico, where multiple federations have been set up to supervise cooperatives, institutions have reportedly switched their memberships to avoid possible sanctions.

For other types of institutions, regulation and supervision can be so strict that it ensures the security of deposits, but limits outreach. In Mexico, banking regulations that mandate expensive infrastructure requirements discourage rural branches. A similar phenomenon is at work in Uganda, where investments required by the new Micro-Deposit Taking Institutions (MDI) Act have at least temporarily slowed branch expansion among newly regulated MDIs.[9] By driving up costs, these regulations can limit safer institutions to wealthier areas. Worldwide efforts to combat money laundering and the financing of terrorism are also threatening to make small transactions unviable for financial institutions.[10]

In addition, partnerships that could help safe institutions extend their outreach are often discouraged by financial regulators in the name of safety. In Bosnia and Uganda, for example, regulators recovering from recent systemic crises have prohibited agency relationships that would allow unregulated institutions to handle transactions on behalf of regulated ones.

It would be irresponsible to suggest that regulations like these be loosened without careful analysis of the implications of such a change. Strict regulation and supervision is, after all, part of the reason that safe institutions are safe. Nor is strict regulation and supervision the primary bottleneck to extending quality deposit services to the poor. Evidence for this can be found in countries like Uganda, where significant donor and government investments in creating a separate regulatory category for MDIs has not yet led to significant increases in outreach.

Furthermore, there is a legitimate place for unsupervised deposit-taking institutions in the financial system, specifically for those that take only deposits from members and are too small to supervise cost efficiently (where supervision costs are measured against the institution's assets). Research in Uganda shows that even unsupervised institutions tend to be safer than informal savings options (Wright and Mutasesira 2002).

[9] The 2004 MDI Act allows a limited number of MFIs that meet high performance thresholds to transform into regulated financial intermediaries supervised by the Bank of Uganda.

[10] For more information, see Isern et al. 2005.

Strategies for Supporting Small-Balance Savings Mobilization

What can be done to help financial institutions provide both safe and accessible deposit services? CGAP's Country-Level Savings Assessments identifies five strategies that could alleviate key demand- and supply-side constraints. Although the importance of specific constraints varies from country to country, the strategies developed are relevant to almost all of the five markets studied.

Document the market. Generating solid data on the size of the low-income market and client preferences for deposit services provides institutions with a sound basis for business planning and product development. Making these data widely available and visible could contribute to a change in mind set that might encourage previously inaccessible institutions to reach out to poor savers with deposit services. Donor-subsidized market studies can increase awareness and contribute to this attitudinal shift. The one market—Uganda—in which CGAP found ready acceptance of the proposition that the poor do save was also the market where client preferences were the best documented.

Help clients make smart savings choices. Many clients find it difficult to accurately assess the risks of different savings instruments, both formal and informal. Consumer education and financial literacy training can help poor clients judge the relative risks of available savings options and use them to manage household finances more effectively.

Client education on how to assess a financial institution's safety is especially valuable. Client knowledge of the indicators of institutional soundness may help alleviate some of their uncertainty about entrusting their savings to formal financial institutions. Such mechanisms could build on the rating systems often used by apexes, federations, and technical assistance projects and can be promoted to clients through public education campaigns.

Increase capacity in accessible institutions and lower costs in safe institutions. To compete more effectively with informal savings mechanisms, financial intermediaries must offer products that combine the security of well-run institutions with the proximity and affordability of informal instruments. For regulated institutions, such as banks, the key is developing less costly delivery mechanisms while maintaining high levels of depositor protection. Technologies such as mobile phones and point-of-sale networks hold promise, but often require substantial up-front investment. In the short term, offering incentives for regulated institutions to reach out to unserved markets may be an effective use of subsidies. For institutions that build points of service in poor areas, incentives could include a share of the government's payments business, temporary exclusivity rights in certain areas, or tax breaks.

For less tightly regulated institutions, such as cooperatives, strengthening management is often more important. Both types of institutions should use data on client preferences to design products that respond to specific client needs. Donors, training and technical assistance providers, policy makers, regulators, and supervisors all have roles to play in helping institutions make these upgrades.

Align liquidity-related incentives. Finding outlets for excess liquidity in strong institutions may heighten their incentive to offer deposit services to poor clients. Helping institutions take and manage intelligent lending risks, for example in the microcredit market, could drive deposit collection. Improved liquidity management mechanisms that enable institutions to place excess funds into safe, remunerative investments also could increase their appetite for deposits.

At the very least, donors and governments should think twice about pumping more liquidity into already over-liquid systems through cheap, easily accessible credit lines. There may be alternatives that better preserve incentives for deposit collection. For example, an emergency liquidity fund that "guarantees" short-term deposits could help financial institutions transform them into longer-term assets. In countries with *very* strict asset-liability regulation, increasing the proportion of short-term deposits that

can be transformed into longer-term loans could be another potential solution. A study of the true stability of short-term deposits in a given institutional or country context should underpin both these strategies.

Establish balanced regulatory and supervisory frameworks. Regulatory and supervisory frameworks exert a strong influence over financial institutions' ability and incentives to provide secure deposit services to low-income savers. In light of past crises, they often exhibit a bias toward ensuring systemic stability. But the restrictions entailed by this approach can inhibit outreach to poor clients. Often, this pressures regulated institutions to innovate outside the law. For such institutions, permitting limited piloting of new products and delivery methods may be a constructive alternative to closing off all avenues for experimentation.

Stronger monitoring is often needed for more accessible institutions, especially for postal banks and large cooperatives that approach the definition of institutions that take deposits from the public. Financial authorities often are reluctant to regulate a plethora of small institutions because of the costs involved. As a compromise, some countries have or are considering delegating supervision to membership-based federations of institutions. These efforts have been largely unsuccessful, and international experiences may hold useful lessons.

For smaller institutions that cannot be cost-effectively supervised, nonprudential systems that involve collecting and posting performance data—as well as communicating clearly to members that these institutions are not supervised—may be a practical alternative. The emphasis on performance data also could help build institutional capacity—a necessary counterpart to improved policy and efficient industry infrastructure.

Conclusion

Poor people worldwide want safe, accessible savings mechanisms. Formal financial institutions cannot fulfill this demand until they can offer services that are secure, affordable, and located where poor clients live and work. In the meantime, poor people will continue to hide money at home, lock up assets in animals, or entrust cash to informal providers—with all the risks those mechanisms entail. Funders, policy makers, and financial institutions themselves must work at all levels of the financial system to align incentives and create the capacity for formal institutions to tap the demand for savings services.

These efforts translate into different activities, depending on the local context. While offering incentives to banks to downscale in deposit mobilization may be the most promising strategy in one country, staunching the flow of subsidized on-lending funds to cooperatives or strengthening postal bank management may be more important in another. Regardless of the specific action, safety and accessibility are the goals. If financial institutions can offer these, they will not only increase access to savings services for poor people, but also create access to a fortune of deposits for themselves.

Appendix: Data on Average Product Costs and Branch Density

In the markets studied, average threshold costs tracked closely to branch density. "Basic deposit products" were defined as the lowest cost savings or transaction account in a given institution. "Threshold" costs are the direct financial costs to open such accounts, comprised of minimum opening balances, fees, and any shares that must be purchased in the case of cooperatives.

Table A-1 gives the range and averages of threshold costs in institutions sampled by country. The institutions represent a cross-section of deposit-taking institutions catering to low-income people—usually mass-market-oriented banks, postal/savings banks, deposit-taking microfinance institutions, and financial cooperatives. For each country, daily minimum wage is also given.

To study the relationship between threshold costs and population per branch, average threshold costs for a range of institutions were converted into a multiple of the local daily minimum wage. (See Table A-2.)

Figure A-1 illustrates high, low, and average threshold costs and compares them against daily minimum wages by country.

When these multiples were compared to average nationwide population per branch, the correlation was -0.78 for all deposit-taking institutions, meaning that, as the number of branches per population increased, the average costs to open an account decreased. The correlation was even stronger (-0.83) when only bank branches were considered. Although based on a limited sample of countries, the results support the expectation that competition between institutions brings down price.

Table A-1 Threshold costs for basic deposit products in institutions sampled, by country

All figures in USD	High	Low	Average	Minimum daily wage
Benin	946.97	9.09	157.43	1.71
Bosnia	6.33	0	0.79	6.55
Mexico	88.50	0.88	34.73	4.04
Philippines	35.66	8.91	14.49	6.15
Uganda	28.29	5.66	9.86	0.11

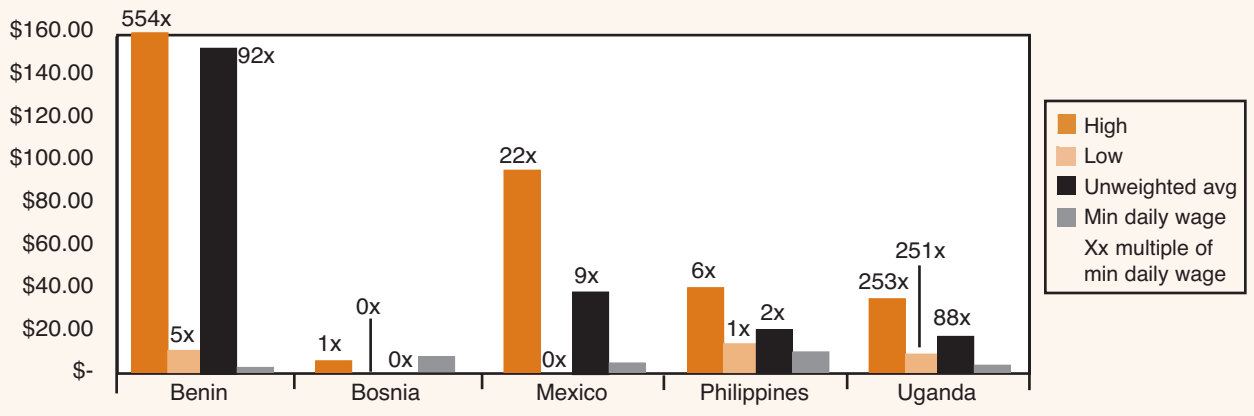
Table A-2 Threshold costs as multiples of daily minimum wage

	High	Low	Average
Benin	554	5	92
Bosnia	1	0	0
Mexico	22	0	9
Philippines	6	1	2
Uganda	253	51	88

Table A-3: Correlations between measures of branch density and threshold costs

	High	Low	Average
Bank branches/million people	0.73	0.56	0.83
Deposit-taking institution branches/million people	0.57	0.72	0.78

Figure A-1 Threshold costs for deposit products



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CGAP
1818 H Street, NW
MSN P3 - 300
Washington, DC 20433 USA

Tel: 202-473-9594
Fax: 202-522-3744

Email:
cgap@worldbank.org