Ignacio Mas
Deputy Director,
Financial Services for the Poor,
Bill and Melinda Gates Foundation

Reframing micro-finance: enabling small savings and payments, everywhere

Micro-finance aims to provide financial tools for people to be able to invest in their productive activities and stabilise their expenditures in food, health and education. Micro-credit is one such tool, but not always the most appropriate. Everyone should have the option to use formal, safe savings instruments to save up for such purposes. Savings services must be available close to where poor people live, which requires going beyond bank branches and delivering services securely in neighbourhood shops. Linking savings accounts to electronic payment networks makes the accounts particularly useful for poor people to access their funds, manage their micro-enterprises and support distant relatives.

The micro-finance movement started as an innovative model to extend credit to poor people. It now stands for a grassroots model of poverty alleviation in which large numbers of poor people are given financial tools that empower them to seek out new and better livelihood opportunities.

This broader vision calls for a reassessment of the core challenges of micro-finance. In particular, there needs to be a greater emphasis on delivering savings options to poor people. The ability to put money away and to access it as and when needed is a fundamental mechanism through which households can manage their well-being and productive capacity. There needs to be a scalable model that makes savings services available to all, in a way that is both affordable for poor people and commercially viable for providers.

The value of savings to poor people

Most people save in order to invest. Their daily or weekly savings are akin to a self-defined instalment plan on their productive assets, life cycle family expenditures (such as marriage or funerals), children's education, or buffers against shocks (crop failure, illness). Households that fund their entrepreneurial and livelihood activities through their own savings can keep a greater share of their business returns than if they fund their investment with credit. Savings may not have the built-in discipline mechanism that is embodied in credit, but puts households more in control of their cash flows.

Like credit, saving helps households turn a sequence of small amounts into useful lump sums. But in more cases than not, households prefer to save rather than borrow because it is cheaper and gives them more control over their lives. Borrowing is a high-stakes decision for poor families. Savings is a safer approach, and one that is appropriate for all families.

The ability to put money away and to access it as and when needed is a fundamental mechanism through which households can manage their well-being and productive capacity.

Academic researchers are now starting to quantify the impact of savings in poor people's welfare. Early results from randomised control studies in Western Kenya reveal that poor people (specifically farmers and women micro-entrepreneurs) find it difficult to conserve cash without access to appropriate savings mechanisms. With access to a savings account, they were able to accumulate larger savings balances which could then be used to make lump sum investments in their business. Those who had greater access to savings show a higher level of daily expenditures including on food than those in the control group.

The daunting challenge of savings

Only about one-quarter of households in developing countries have any form of financial savings with formal banking institutions. Even in countries that have experienced substantial development over the last decade or two, this statistic remains stuck stubbornly at a level that would not be acceptable for any other

Photo 1: An informal savings-led group in Tanzania: tapping into community trust.

Photo: © Amina Tirana

Photo 2: A bank branch in Tanzania: maybe safer, but certainly a lot less convenient.

Photo: © Bill & Melinda Gates Foundation

measure of socio-economic development: 10 per cent in Kenya, 20 per cent in Macedonia, 25 per cent in Mexico, and 32 per cent in Bangladesh.

In order for formal savings services to be relevant to poor people, formal financial institutions need to be able to capture these savings 'at source', that is, right when and where the money is earned. Every time a poor person earns money there is a potential savings opportunity. People must be able to deposit (and withdraw) money near the places where they live and work.

Many financial institutions, especially large commercial banks, find it too costly to reach out to poor customers despite the strong latent demand for savings. Current business models do not handle the 'triple whammy' of low savings balances, small transaction sizes and large numbers of customers. Financial institutions find it difficult to justify commercially the roll-out of a broad-based retail infrastructure to serve poor households. They therefore pass on the cost of access to poor customers, directly through high fees and indirectly by requiring them to spend time and money to travel to distant branches.

In turn, many poor people reject financial institutions that seem focused on serving wealthier customers. They don't trust them to treat their less lucrative depositors fairly, and don't feel welcome.

Meeting the savings challenge

A couple of decades ago, few believed that the poor – who face unstable income streams and often lack legal title to assets – were good subjects for formal credit: credit spreads would need to be beyond what poor people could afford. But innovations around the structuring of micro-credit products and delivery mechanisms have shown that despite the adversity faced by poor people they incur low default rates.

Now we face a similar challenge around savings: how can we deliver low-balance savings services sustainably to poor people? Specifically, how can we make savings profitable, without necessarily tying the provision of savings to the use of credit?

The following section provides an overview of the savings discussion around four key elements that underpin the viability of formal micro-savings offerings: the competition from informal savings mechanisms, the importance of formal trust-building through branding and marketing, the problem of distribution, and the complementarity between savings and payment services.

Understand your competition: from informal to formal savings products

Developing micro-finance opportunities is about creating a compelling proposition that beats the informal options that poor people have traditionally used. This is harder for savings than for credit: informal credit is often available from very few sources, and is extremely expensive and risky. But poor people save small balances through a variety of informal mechanisms: hiding cash at home, loaning funds to relatives, participating in savings groups with their neighbours, buying livestock or jewellery. This surprising diversity of savings mechanisms reflects the fact that none meets the full range of needs of poor people.

A major limitation to informal savings mechanisms is that they operate strictly within the family or community where the saver lives, and hence require the saver to rely on other poor people in similar circumstances. This introduces an unhelpful covariance between a household's condition and its ability to draw value from savings: the household's savings will be least effective when they are needed the most. Informal arrangements tend to be short-term, as people need to continuously test the trustworthiness and liquidity of their savings arrangements. Local informal savings arrangements also tend not to be portable, making it difficult to transfer one's savings to another community (e.g. when seeking employment in another city). Many informal savings options like livestock are not divisible, and hence not useful to meet daily needs.

Thus, financial institutions need to figure out how poor people save today, and identify the specific ways in which their offering will be more convenient, more reliable or cheaper. Photos 1 and 2 (above) depict very different user experiences from informal savings-led groups and bank-based services in Tanzania; bank customers must clearly bear a burden of time and aggravation to avail themselves of the formal services. Informal savings must be seen as part of the competitive landscape by financial institutions wanting to mobilise substantial deposits in poor communities.

Photo 3: A retail banking agent in Brazil.
Photo: © CGAP

Photo 4: An M-Pesa agent in Kenya.
Photo: © Olga Morawczynski

Earning the trust: the importance of brand and scale

Financial services are fundamentally about managing information and trust. Extending credit involves the financial institution trusting their clients, but savings reverses the direction of trust. Therefore, in the case of savings, the financial institution needs to be able to transmit to their clients the notions of financial prudence, liquidity and permanence (your funds are safe and readily available). When they issue savings accounts, the product financial institutions sell is reassurance. Therefore, shifting from a system based on credit to one based on savings entails a large investment in brand building. This requires creating a clear positioning for the brand, driving awareness and maintaining a continuous presence in people's minds.

> If the distribution problem is solved, one can expect financial institutions to be better able to innovate and market the right products to a broader set of customer segments, including poor households.

As a result, the economics of savings and credit are quite different. The savings model entails significant fixed costs around brand marketing and branding, while credit entails more localised loan officers and hence is much less subject to economies of scale. Therefore, micro-finance institutions wanting to tackle the savings challenge for poor people will need to operate at a substantially larger scale than what most micro-credit institutions have achieved to-date, and acquire much stronger branding and marketing skills.

The problem of distribution: banking beyond branches

Financial institutions' main barrier in offering savings is the high cost and limited territorial reach of their branch-based distribution. Bad product features (e.g. high minimum account balances or monthly fees) are more often than not the result of poor economics for the financial institution. If the distribution problem is solved, one can expect financial institutions to be better able to innovate and market the right products to a broader set of customer segments, including poor households.

Financial services might benefit from the extensive indirect distribution channels that most other products enjoy, which allows them to be present in a broad array of local shops. This would allow poor people to conduct transactions securely at a shop near where they live or work, without having to count on their financial institution establishing a bricks-and-mortar presence there. Depositing and withdrawing money from your account should be just another product that your local store offers, along with toothpaste and mobile prepaid cards. Photos 3 and 4 (above) show retail outlets at which poor people in Brazil and Kenya can cash into and cash out from their accounts.

> To achieve universal access, new banking systems are needed that work for the poor and yet are commercially sustainable.

We can now use technology to ensure that banks and their customers can interact remotely in a totally trusted way through local retail outlets. Customers can be issued bank cards (whether physical or embedded in their mobile phones) with appropriate security features, and the local store can be equipped with a point-of-sale device (a dedicated terminal or a mobile phone) controlled by and connected to the bank via

Photo 5: Three ways to send a payment domestically in Kenya.
Photo: © CGAP

a telecoms network. If a customer wishes to make a deposit at a store, swiping his card puts him in direct communication with the bank. The bank automatically withdraws the equivalent amount from the store's bank account to fund the deposit, and issues a receipt to the customer through the point-of-sale device. The store keeps the cash in compensation for the amount taken out of its bank account.

If the next customer wishes to make a cash withdrawal, the opposite happens: the store provides cash from the till, but is compensated by an equivalent increase in its bank account. Of course, the store manager will at some point need to go to the bank to balance the till. In effect, the bank customers have 'delegated' to the store manager the bothersome (and, in some cases, risky) job of having to go to the bank to balance the community's net cash requirements, and for that the store gets a commission per transaction.

Making savings useful: payments as a driver for formal savings

Savings accounts have most value when they are connected to payments systems. In the same way as access to clean water is more than being able to buy a bottle of water, access to finance is more than being able to get the occasional loan. Much like the national grid, access to finance really involves being connected to a national payments system.

Once people have a transactional account in a 'payment grid', they can receive and repay loans, save up and withdraw from a savings account, and use the proceeds to pay for what they need in a more flexible, convenient way. And it enables financial service providers to offer a broader range of services to them at lower cost. Photo 5 (above) shows competing mobile money transfer services in Kenya: the bank-based Postbank, the mobile phone account-based M-Pesa, and the non-account-based Western Union.

Can this model work?

This vision – of banking beyond bank branches – is now coming true. Brazil has seen 37,000 such retail 'bank correspondents' (stores offering deposit and withdrawal services on behalf of banks) open up, most in the last five years, with the result that all municipalities are now covered by the formal banking system. In Kenya, the M-Pesa mobile money service in its origins relied on a mobile operator's broad prepaid card distribution network to double up as cash in/cash out points. Such models also exist in the Philippines, South Africa, Peru and Colombia, and are being piloted across many countries in Africa.

To achieve universal access, new banking systems are needed that work for the poor and yet are commercially sustainable. These systems need to be built on low-value, high volume platforms, leveraging retail infrastructures that already exist. Low-value transactional savings accounts – which are merely the gateway to a range of banking services for the poor – should involve lighter regulation because of the lower risks and the relative simplicity of the product. If these models prove sufficiently replicable and scalable, it will be possible for millions of people to make small deposits into their bank account through a variety of cash handling outlets right in their neighbourhood, on a daily basis, as and when money is earned. This will enable poor people to manage more effectively their productive activities and daily cash flows, build up assets, and handle health or livelihood shocks.

Ignacio Mas is Deputy Director and leads on research, policy and financial infrastructure work in the Financial Services for the Poor programme at the Bill & Melinda Gates Foundation. His career spans roles in policy (with CGAP and the World Bank), the private sector (Vodafone and Intel Capital) and academia (University of Chicago).

Guided by the belief that every life has equal value, the Bill & Melinda Gates Foundation works to help all people lead healthy, productive lives. In developing countries, it focuses on improving people's health and giving them the chance to lift themselves out of hunger and extreme poverty. The Financial Services for the Poor initiative aims to increase the poor's access to a range of low-cost, high-value financial services that better enable them to meet daily needs, cope with risk, and lead healthy and productive lives.

PO Box 23350
Seattle
WA 98102
USA

Tel: +1 206 770 2120
+1 206 709 3100
Email: ignacio.mas@gatesfoundation.org
info@gatesfoundation.org
Website: www.gatesfoundation.org