SAVINGS: BUILDING THE FUTURE

CONTEXT

Over a period of several years, DID partners have tested numerous strategies dealing with accepting savings deposits. Based on this experience, DID has drawn up certain guiding principles. These convictions acquired over the years should serve as guidelines in outlining strategies to use and the products to offer and/or to develop, especially products aimed at disadvantaged populations.

DID is therefore proposing, in the form of statements, a policy regarding savings deposits and how to manage them which is intended to contribute to achieving the following objectives:

- Fostering access to financial services for the disadvantaged
- Optimizing local savings capacity
- Reaching a level of financial and organizational sustainability for providing financial services
- Enabling the empowerment of people in the community

***Needs* of the targeted clientele**

DID recognizes savings deposits as a primary need that has been expressed by a vulnerable clientele. Savings are part of a diversified and relevant offer of products and services aimed at meeting the various needs of a vulnerable clientele on an equal footing with credit, insurance, access to payment systems, etc.

No matter in which country they live, poor households make use of savings deposits in different ways and for various purposes. They save regularly when cash flow allows it and did so well before using credit products. Several studies note that they tend to deposit their savings in financial establishments which they trust and that have suitable savings mechanisms which meet their real needs. Savings are a means to reduce their vulnerability by compensating for irregular income. The needs and reasons for saving change as the financial situation of households improves, demonstrating the need for the institution to be proactive.

Poor households save for various reasons: as insurance against illness, disability or other unexpected events, to avoid waste, build up capital for commercial activities, launch a project, become eligible for a loan, meet social or religious obligations, for future purchases or as an investment.

The method and place they choose for their savings efforts is influenced by the capacity of the institution to respond to their real needs: security, liquidity, proximity and net remuneration.

The security felt by the clients generates confidence in the institution. In a study performed in Mali and Benin,[1] some respondents emphasized their mistrust of the informal sector and its lack of reliability. Liquidity is an important criterion for poor households who need fast access to their funds in case of emergency or an investment opportunity. In addition to this criterion, the flexibility of the products offered is also a major consideration.

[1] *Produits et services d'épargne du secteur informel et des institutions de microfinance en Afrique de l'Ouest : cas du Mali et du Bénin,* Micro Save-Africa and Développement international Desjardins, Mai 2000, 50 pages.

The relationship between accessibility and transaction cost is to be taken into consideration by the institution offering the savings deposit service. The sensitivity of the clientele to elements such as the time required to travel or just to line up and the hours open for business may represent inconveniencies and a cost which makes savings efforts unattractive especially for a clientele of entrepreneurs. It should be noted that meeting conditions and fulfilling formalities may also hamper access to community finance institutions. The total inconvenience may induce small-scale savers to turn to the informal sector.

Throughout the world, experience shows that people's propensity to save has a direct correlation to interest rates offered and that this is valid for all savings depositors including the poor. As their situation improves, the clienteles targeted by community finance institutions become more sensitive to true interest rates especially longer term deposits.

Savings deposits and economic development

DID recognizes savings deposits as a tool for leveraging development and self-sufficiency for individuals and institutions.

A slogan used by the Desjardins Group in the 1970s identified savings with freedom. In terms of development, DID firmly believes that savings deposits are the path to freedom and independence.

THE INDIVIDUAL'S POINT OF VIEW[2]

Access to community finance institutions allows those excluded from the classic banking system to build up their savings in a fully secure and equitable manner without social, racial or gender considerations. For this clientele, security can take several forms, with initial priority on physical security for the individuals and communities in general. The impact assessment from Burkina Faso shows that the rate of criminal banditry in some sectors decreased with the arrival of community finance institutions. Moreover, it has been recognized that the use of banking services counteracts the negative effects of hoarding. Another important element of security is the assurance that deposits will be safeguarded without having to distribute them to the direct or extended family. Finally, security is linked to the fact that in a context of changing climate, economic conditions or health concerns, savings deposits help stabilize income. As a result, savings deposits make it possible to benefit from the advantages provided by insurance coverage or an emergency loan which are often not accessible or available.

In contrast to productive credit or consumer credit, savings deposits are often utilized for acquiring essential goods over the short term, especially food, or to deal with health problems for family members. Savings are also built up over the long term for clearly identified projects requiring considerable planning such as housing or starting up or expanding productive activities.

Savings are as important as credit. The chance to save makes it possible to buy goods or services that otherwise would not be available if the financial resources were used up. Without savings, a household is more likely to experience difficulties causing it to lose what it has achieved. Moreover, development of the reflex to save facilitates access to credit and is a habit that is given major consideration during the loan approval process.

[2] For complete information, see The Impact of Savings and Credit Cooperatives in Burkina Faso, DID Notebook 19 Développement international Desjardins. Available in French and English at www.did.qc.ca.

THE INSTITUTION'S POINT OF VIEW[3]

Towards the end of the 1990s, when microcredit achieved widespread popularity, DID confirmed its fundamental orientation of making financial services available by developing financial institutions whose main resources would come from the communities serviced, unlike credit outlets simply dispensing funds obtained externally.

This type of position usually draws two major criticisms. The first questions the potential of poor clients to save. Nonetheless, even in the poorest communities DID partner networks are currently attracting sufficient savings deposits to meet the needs for credit. As of December 31, 2004 the savings deposits mobilized by the 3 million clients of DID partners reached CAN $860 million for a loan volume of CAN $778 million. More specifically, in Africa, average savings deposit of the seventeen networks of DID partner cooperatives is CAN $140 and varies among the networks from CAN $35 to CAN $660, for an average loan of CAN $710 (ranging from CAN $208 to $3400).

In Latin America, average savings deposits per client among DID partners are CAN $1035 for an average loan of CAN $1245, while in Asia the respective averages are $100 and $560. This data illustrates two major elements: first, it is possible to collect substantial amounts of savings deposits despite limited resources among the target clientele and second, with 69% of savings converted into credit in Africa (98% in Latin America and 171% in Asia), DID partners are clearly rooted in a true process of intermediation, both financially and socially.

This institutional aspect results in a second criticism, attacking the longer period ncessary to set up or consolidate these institutions. Deployment stretched out over a long period is certainly a direct consequence of an institutional development approach. The result, however, is different from an outlet simply distributing credit products using funds obtained outside the community. Instead it produces a financial institution anchored in its community offering diversified services on a permanent and sustainable basis.

A few years after microcredit had become a phenomenon, some actors in the sector began to proclaim the importance of developing the habit of saving in poor communities by saving a small sum over the short term. The movement grew as it was observed that the credit development based on international charities simply did not allow for local mobilization of savings deposits and made any initiative for the development of credit dependent on donor agencies. Moreover, it was observed that advancing funds at subsidized rates further complicated the initiatives to mobilize savings deposits.

All these observations supported the conviction at DID that mobilizing and recycling funds on a local basis encourages community involvement: savings deposits provide significant leverage towards the self-sufficiency of community finance institutions.

ECONOMIC DEVELOPMENT

Many studies show that a high rate of savings fosters more sustained economic development on the condition that the savings are converted into productive investments. This contribution to local economic development diminishes poverty and increases prosperity leading the community to enrich itself and build a better future. DID favours considering savings deposits as an important pillar for the development of local financial institutions providing true financial intermediation. This involves taking surplus funds that are not earning a sufficient return for the risk incurred and which are held by certain individuals or institutions and transferring them to other users who lack funds for investment purposes.

[3] Based on *Development of community finance: lessons learned in recent years.* From Développement international Desjardins, Développement international Desjardins. Available in French and English at www.did.qc.ca.

Growth in the financial sector would thus facilitate mobilizing resources, which would then be more accessible to those creating economic activity. The first step towards more sustained financial intermediation foster regional savings deposits. Savings are generally the first form of capital accumulation and as such are an important phase in a country's economic development.

Target clientele

DID encourages community access to savings deposit services, without restriction based on client categories and supports the development of flexible products for various clienteles with the goal of achieving sustainability.

The clientele targeted by community finance is characterized by lack of access to financial services from the formal sector. This clientele includes vulnerable individuals who are offered savings deposit services. These are individuals or operators in the informal sector who cannot meet the requirements of the traditional financial system. The traditional system generally sets conditions that are too restrictive and which limit or make access to financial services impossible for the vulnerable.

Women constitute a large share of those excluded from the traditional banking system. According to statistics they constitute the majority of the poor on every continent. Women offer a large potential for mobilizing savings. They often manage the family budget and/or operate a business in the informal sector and are more inclined to pay for needs linked to health and education which leads them to save regularly until the need is met. Men are characterized in their savings habits by their efforts to accumulate lump sums to invest in expansion of a family business.

DID is of the opinion that, taking into account the strict requirements of capital and the obligation to reduce operating costs, the soundness, sustainability and recognition of a community financial institution is based on a clientele composed not just of the poorest, but also of men and women who are striving to improve their economic condition. The absorption of operating and development costs requires income and economies of scale that are only possible by offering a variety of products to a diversified clientele.

Prerequisites

DID believes that the mobilization of savings deposits is based on prerequisites for the institution both in terms of the economic environment as well as the institutional environment in order to ensure sustainability and profitability.

THE ENVIRONMENT

Stability of the macroeconomic environment

The capacity of an institution to mobilize savings deposits successfully depends first on an economic environment that will allow it to function at a viable and sustainable rate to be able to adequately remunerate the savings deposits of its clients in order to protect their purchasing power. It is difficult to mobilize savings deposits if there is political instability or a high annual rate of inflation. In times of uncertainty, non-financial assets offer the best guarantees against instability thus inducing households to diversify the types of property they hold. Moreover, if the State regulates interest rates, the management of the institution is limited, and as a result it is more difficult to make activities profitable. The mobilization of savings deposits requires a suitable macroeconomic environment, a reasonable degree of political stability and sufficient population density.

The combination of these conditions facilitates the collection of savings deposits in a profitable manner. It is of primary importance that institutions involved in collecting savings deposits ensure permanent professional management to overcome difficult times.

Existence of a suitable regulatory framework

The mobilization of savings deposits is an agreement between two parties: the institutions which accept the deposits and the individuals who agree to place their savings with the institutions. Collecting savings deposits from the public means operating under a suitable regulatory framework. Proper legislation contributes to professional and transparent management of operations and avoidance of abusive practices. This builds security and confidence in the community finance institutions.

In the absence of a regulatory framework suitable for community finance, DID promotes the development of flexible rules. DID also gives its support to the development and application of an internal regulatory policy governing the basic foundations of a savings and credit institution, rules for certification and main regulations.

Supervision[4]

With the aim of protecting the interests of clients, especially depositors, institutions which mobilize savings must be supervised both internally using a mechanism that is adapted to the circumstances, and ideally also by the same organizations that promulgated the legislation, or institutions mandated by them.

Effective surveillance relies on a sound legal system, standardized supervision conditions, a true capacity for supervision, an established framework for standardization and the authority to enforce it.

THE INSTITUTION

Confidence

To mobilize savings deposits an institution must necessarily earn the confidence of depositors. In offering deposit services, institutions must take measures in order to protect the deposits of their clients. This requires professional management and sound governance. In the case of an institution in startup phase, confidence may be fostered by support from the government, respect for the law, the credibility of the execution agency, the support of local leaders, the support of local political authorities, etc.

Much more than just a product, savings deposits are a matter of confidence. An impact assessment in Burkina Faso[5] clearly shows that for clients, savings deposits are linked to security. Institutions build client confidence initially by allowing them to deposit their savings in complete confidence and allowing them to withdraw them with no problem. The soundness and reputation of the institution is of prime importance. It must be solvent, maintain a high rate of recovery and demonstrate its capacity to meet its commitments. The institution must establish control methodologies for delinquency and reserves for losses on loans and maintain a general reserve in order to protect deposits.

Transparency

Institutions accepting savings deposits must be concerned with transparency. Clients deserve full disclosure with accurate and understandable information about the terms and conditions of the products and financial or non-financial services available, including service and transaction fees and the return on savings deposits.

[4] For full information, see DID policy statement on supervision.
[5] See note 2.

Quality information of this type will avoid illusions and poor interpretations that cause dissatisfaction. Financial service institutions must be committed to promoting practices that guarantee clients the information required for enlightened decision making.

Professionalism

Mobilizing savings deposits and managing them effectively to protect their value requires professionalism from the staff. The institution must see that they are able to properly serve the clientele. Employees accepting deposits from clients must be honest and professional, offer a warm and courteous welcome while remaining discrete, and take a personalized approach with the clients. These conditions foster a relationship of confidence with the client that will result in greater customer loyalty. In order for the personnel to serve the clientele in accordance with the expectations of the institution, priority should be placed on establishing a client service policy to oversee operations and tasks.

Infrastructure

Growth in deposits will be strongly correlated with the perception of the soundness and professionalism of the institutions mobilizing savings deposits. Attractive and secure facilities will foster a professional image in which depositors may have confidence. For example, grillwork on windows, solid buildings, installations separating the cashier from the public, drawers with keys, and a vault are elements that will build depositor confidence.

Operating system

Opening savings deposits for a clientele widened to include small-scale as well as larger depositors results in a large number of transactions for small amounts placing pressure on operational efficiency. Setting up efficient operating procedures and systems for collection of deposits, developing work methods and giving staff greater responsibility are essential to ensure security, employee performance and limit errors and fraud while protecting deposits and profitability.

Internal control

Institutions which mobilize savings must perform vigourous internal control by introducing standards, procedures and mechanisms to supervise all transactions in order to avoid fraud and detect problems quickly in order to protect the interests of the clients, especially depositors.

Standards supervising deposits

DID promotes the establishment of prudential norms supervising deposits among its partners to ensure security for depositor savings.

Playing a role of financial intermediation is more complex and very different than simply granting loans, especially in terms of financial management and managing the security of the funds. The application of prudential norms is intended to assure sound and prudent uses of deposits and foster a sound financial situation to support a competitive and equitable financial system.

Standards for liquidity

By acting as a financial intermediary, a community finance institution is exposed to the risk of financial loss resulting from default on the funds maintained to meet financial obligations. If the institution does not maintain adequate reserves to meet its daily needs for disbursing loans and depositor withdrawals, it risks losing the confidence of its clients and creating a demand for massive withdrawals. Growth in the number of transactions and less predictable cash flow make the management of liquidities more complex.

To reduce the liquidity risk, community finance institutions must be able to forecast and manage cash flow. They must have accurate control over entries of funds (deposits and loan repayments) and disbursements (disbursement of loans and depositor withdrawals) using a monthly cash flow statement, and they must have a contingency plan.

Standards dealing with matching terms and currencies

As financial intermediaries, community finance institutions must protect themselves from losses that could arise from interest rate fluctuations. By mobilizing savings deposits, they run the risk of suffering from the interest rate structure charged on loans in relation to the interest they pay on term investments. Careful management involving matching the terms of deposits and loans is imperative.

In the same manner, when an institution offering savings services in foreign currency lends in local currency there are risks of financial loss based on a variation in exchange rates. The institution must develop management capacity and set up suitable mechanisms before undertaking these types of transactions.

Standards dealing with diversification

Mobilization of savings offers the institution the necessary potential to extend its services at the same time that it builds a diversified capital base to finance its loan portfolio. However, it must set limits in order to avoid too large a concentration of savings deposits in the hands of a small groups of depositors. Such a concentration would expose the institution to possible massive withdrawals by this group. It would also betray its social mission by limiting access to savings deposits to a small number of persons.

The importance of savings deposits as a source of funding

DID promotes prioritizing savings deposits as a source of funding without however eliminating recourse to external financing.

Although DID supports the creation of community finance institutions through the mobilization of local savings deposits, it does not eliminate the option of using or resorting to external financing. DID believes that community finance institutions should always strive to maintain savings deposits as the primary source of funds, before calling on external financing. If the demand exceeds the offer or if emerging networks do not have the time to make full use of deposits, external sources could be called on under the condition that they are used in proportion to the demand and certain ratios are respected to ensure the security of savings deposits. Community finance institutions should always strive to maintain savings deposits as the primary source of funds while ensuring that they have a financing mechanism at their disposal (line of credit, refinancing facilities with a bank etc.), making it possible to manage any eventual pressure on liquidity.

On the other hand, DID shares the idea that the use of external financing from donor agencies that impose some requirements may be highly negative. Institutions must be able to refuse to meet requirements whereby the funds granted force them to abandon their market or mission and require them to loan under conditions that are incompatible with other products or methodologies of the institution. The importance of using external financing is a function of several criteria, especially the maturity of the institution, its level of integration into a network, its level of profitability and capitalization and the quality of its loan portfolio. The institution must remain autonomous and free to use the liquidities that are deposited with it.

The use of funds dedicated to specific use must therefore be accompanied with resources allowing the capacity building needed for sound operations in the targeted new markets especially agriculture, housing and small-scale entrepreneurs.

Methodology and the development of savings products

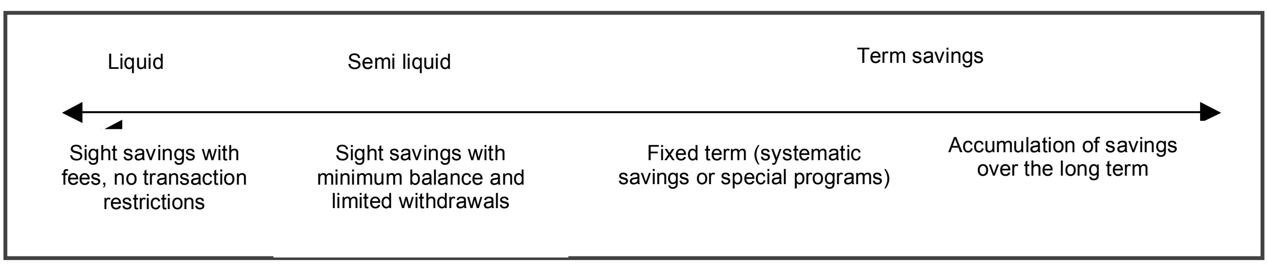
DID suggests proactive management of savings deposits through a process of client education, the establishment of attractive products and through effective marketing.

Sustainable access to community financial services relies on sound and effective institutions that respond closely to the needs of their clients. It is known that poor households are ready to deposit their savings with financial establishments when the process of delivering services and the savings products proposed meet their real needs.[6]

It is therefore essential for the institution to survey the needs of depositors in order to offer savings products and services that fulfill the expectations of the target clientele. In this manner, they ensure that savings products marketed meet the expectations of clients and are adapted to community concerns (rural and urban environments, seasonal variations in needs) while remaining consistent with the goals of the institution.

DID suggests offering a small number of savings products that are attractive and effective, developed according to a tested methodology and designed for the market. DID places priority on developing simple products that are accessible and include remuneration. The simplicity of products facilitates understanding by the clients and sales. Even if clients are more sensitive to liquidity and security of deposits than to the interest rate, experience shows that savings deposits increase if they are remunerated. Remuneration takes on more importance for larger amounts invested for longer terms.

The institution must keep in touch with the needs of its clientele and adjust accordingly. A proactive institution will be able to handle a threat from competition or changes in the market. Since the targeted clientele does not constitute a homogenous group in terms of savings needs, the products delivered must range from liquidity to return. It would thereby be possible to find a combination of diversified savings products that are gradated and remunerated according to their level of liquidity and duration as illustrated below. However, it is recommended that a limited number of products be maintained so that their management does not become unduly complicated.



The mobilization and management of savings deposits requires specific skills that it is necessary to develop or consolidate through suitable training of the staff. The development of skills for "selling" savings deposits and sensitizing clients must be taken into account in order to properly undertake the activity of accepting savings deposits. The development of marketing tools and support for sales, such as deposit simulations, are good methods to facilitate understanding, support the awareness process and arrive at the sales of savings products and services.

[6] *Produits et services d'épargne du secteur informel et des institutions de microfinance en Afrique de l'Ouest : cas du Mali et du Bénin,* Micro Save Africa and Développement international Desjardins, Mai 2000, 50 pages.

Information obtained in a market study may be useful to refine products and services and modulate promotional messages adapted to local conditions. Most of those who are not clients of community finance institutions generally know very little about the range of products and services offered. Ongoing awareness and information campaigns on products and services offered can counteract lack of knowledge about the institutions and their products on the part of both current and potential clients.

Coaching or education strategies may be employed but their cost and management should not be assumed by the financial institution. They may be financed separately or through an alliance set up with groups, NGOs or other local projects. This method makes it possible to capitalize on a wide range of skills without weighing down the financial institution with responsibilities outside its initial mandate.

Tarification and cost of delivering savings products

To withstand the test of time and continue to deliver financial services to clients, financial intermediation activities must be developed and run on a profitable basis.

The fact that savings deposits are an inexpensive source of the funds is an incentive for collecting savings deposits. However, experience at DID shows that the costs associated with the mobilization of savings deposits cannot be reduced to the simple cost of the funds or the remuneration of the savings deposits. In fact remuneration on deposits often appears marginal in relation to the costs incurred for transaction services (infrastructure, salaries, work organization, internal control and inspection services) which allows for good accumulation of savings in current accounts. This is especially true for current accounts, popular with clients for their flexibility. Current accounts at some DID partners represent more than 80% of total mobilized savings deposits. Opening up to savings deposits often implies a large new number of current transactions (deposits and frequent withdrawals) which generates a strong need to optimize their processing.

It is for this reason that DID promotes development of strategies to reduce the costs linked to collecting savings deposits. These include developing simple savings products by establishing a system of interest rate differentiation and remunerating accounts maintaining a minimum balance. Strategies such as account tarification, minimum amounts for deposits and withdrawals and accounts with minimum balance for remuneration are appropriate. The introduction of term investments at fixed rates should be prioritized due to their lower management costs. This type of savings require few transaction operations and offer funds for loans at longer terms. However, this type of account is sensitive to interest rates demonstrating the need to match terms. To ensure the profitability accepting savings deposits, DID proposes using the principle of product cost when setting rates and/or remunerating savings products proposed by the institution.

Computerizing operations with transaction application software generally increases productivity and decrease costs. It also allows for an increase in the number of transactions per cashier, reduces the time required for daily closing, stress on employees and the risk of error and fraud, while providing accurate and fast data which has a major impact on management. Computerization of operations improves institutional efficiency by concentrating efforts on business development and reducing operating problems. Improvement in the quality and integrity of operations makes it possible to proceed with collecting deposits at a lower cost while increasing client confidence in their institution. DID believes that new institutions that wish to operate in financial intermediation should start up with their operations already computerized just as it would be to the advantage of existing institutions to computerize their transaction system where the volume of transactions justifies it.

Installations needed for accepting savings deposits

DID favours setting up physical installations to collect savings deposits but approves the development of mobile collection of savings deposits[7] under certain conditions.

Various studies show that close proximity is an essential condition for reaching vulnerable clienteles. The closer a community finance institution is to its clients, the more it will attract small-scale depositors. DID believes that savings should be collected in a facility set up for that purpose (solid building, windows secured with grillwork, safe), and which has suitable internal control practices. In more remote zones where the business potential would prove profitable, DID promotes the development of service outlets reduced to their simplest, such as an employee in charge of all savings operations. Loan applications may also be accepted at this point of service and be forwarded to the nearest full service outlet.

In places where any other mode of organization represents excessive costs for potential savings deposits, the principle of mobile collection of savings deposits can perhaps be envisaged. Experience shows that it is especially while collecting deposits that fraud can occur. That is why security mechanisms and internal controls such as those found in the base institution should be implemented although in an adapted and even more rigourous manner. The institution must ensure control over the whole process. This type of service may take various forms such as collecting proceeds from local merchants or from a rural clientele according to its nature. It is necessary to adapt control measures. Setting up rotating teams, teams of two collectors, pre-numbered transaction slips in two copies that are documented and signed by the collector and by the client, establishment of an agreement between the client and the institution to make equal payments at the same frequency and visits to the financial cooperative to update passbooks are some examples of effective procedures to spot errors quickly and detect fraud. Not only is it necessary to ensure the security of the deposits but the security of the collector must also be ensured through mechanisms such as regular changes to the itinerary, activities undertaken only in daytime and protection against collusion. Above all, such activities must cover their operating costs.

CONCLUSION

Encouraging the mobilization of savings deposits in a community fosters development of individual and community assets. This encourages development through the empowerment of the community while providing the financial institution with a source of funds. By adopting the role of financial intermediary, the institution will develop a concern for the security of depositor savings, through strengthened internal control, through matching of its funds and especially the costs generated by the mobilization of savings which require more professional management. Savings deposits do have a cost and it is not simply the direct remuneration of the funds deposited.

Moreover, it has been established that the more confidence that clients have in their financial service institution the more they are inclined to deposit their savings with it for longer terms and in greater amounts. To be able to offer deposit security to clients, institution must provide sound and prudent management that will benefit its profitability which is the most tangible measurement for clients to evaluate the security of their deposits.

An institution will experience many advantages when the effort has been made to deliver savings products and it has developed its operating capacity to manage the financial risks inherent in financial intermediation. DID remains convinced that the mobilization of savings deposits can offer community finance institutions the possibility of widening their horizon of intervention, improving their reputation and their rootedness in the community while making service delivery sustainable.

[7] Mobile colllection of savings means that savings deposits are collected elsewhere than at the facilities of the community finance institution. The collector walks or drives to make collections.