

**THE WAY FORWARD: SOME SUGGESTIONS FOR BRAC  
ON MOBILIZING VOLUNTARY SAVINGS FROM THE PUBLIC<sup>1</sup>  
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## **I. Introduction**

Microcredit institutions that undertake to mobilize savings from the public face a number of crucial management, organizational, and operational challenges as the institution becomes a financial intermediary. This transformation generally requires a major shift in attitude on the part of managers and staff, substantial management and staff training, learning to serve new kinds of clients, differences in cash management and asset-liability management, upgraded security facilities, changes in internal controls and supervision, and the like.

The organization's management, and its information and reporting systems must develop the capacity to deal with the increased complexity. Managers need to be financially skilled as well as committed to microfinance. And major organizational changes are often needed to bring about these changes. High quality management, accountability, simplicity, and efficiency are key factors found in successful microfinance intermediaries.

Microcredit institutions that become financial intermediaries can provide service to large numbers of poor savers and can finance large microcredit portfolios – both important component of poverty alleviation.

This report is based on my visit to BRAC from January 7-13, 2003. I am much indebted to the many people at BRAC who went out of their way in this brief period to help me to learn about this remarkable institution. I had the opportunity to make field visits and to meet with those at all levels who are responsible for BRAC's microfinance activities. Many people gave very generously of their time, and I am most grateful.

## **II. Sequencing the Introduction of Voluntary Savings Mobilization from the Public: An Overview**

Suggestions are made in this report for steps that BRAC can take towards mobilizing savings from the public once the Bangladesh Government's regulatory framework is in place.

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<sup>1</sup> Parts of this report are based on ideas that have been explored in my book, *The Microfinance Revolution*, volumes 1 (2001), 2 (2002), and 3 (forthcoming 2004).

This discussion assumes that at least in the initial stages BRAC NGO will be the implementing institution. This is in part because of regulatory issues: if the BRAC Bank mobilizes these savings, it will be allowed to lend only 10 percent to the NGO (and most of its funds will therefore not be available to be lent out in the NGO's microcredit portfolio). And it is in part because the bank is new. The bank has relatively few branches and the SME offices are not set up as financial intermediaries. In future, however, depending on how the regulatory framework develops, the relation between the NGO and the bank in this regard might be reconsidered.

The steps discussed below can be expected to cover a period of perhaps 3 years. It must be emphasized, however, that timing estimates can be only approximate because the overriding principle is that at each step that has been undertaken must be working well before the next step is taken.

The period under discussion here covers preliminary work, a first pilot project in one district, a second pilot project in about 10-12 districts, and the gradual expansion of the new savings products and services to all BRAC area offices.

However, this discussion does not cover the period of market penetration that must follow – when each area office will need to institute systematic identification of, and contact with, potential savers throughout its service area. This is required to mobilize savings widely from all types of individuals, associations, and institutions in the area. The market penetration phase begins after the expansion of voluntary savings services for the public to all area offices, and is several years away for BRAC.

The assumptions underlying the proposed plan that is discussed here can be found in the four appendices to this report:

- Appendix 1: Eight Principles of Savings Mobilization for Commercial Microfinance
- Appendix 2: Risks of Introducing Voluntary Savings from the Public
- Appendix 3: 20 Steps to Introduce Voluntary Savings from the Public in Regulated Microfinance Institutions
- Appendix 4: Stages of Development and Performance at BRI's Unit Desa Savings Mobilization Program.

### **III. The First Steps: Preliminary Activities**

Some activities must be undertaken before the first pilot project in savings mobilization is begun. They can be started even before the regulatory framework is established. These first steps include selecting the managers who will be responsible for the institution's shift to a microfinance intermediary, conducting demand research, designing and pricing products, selecting the district where the first pilot project will be conducted, and conducting training for the managers and staff who will participate in the pilot project.

### ***1. Selecting the managers who will be responsible for the institution's shift to a microfinance intermediary***

The single most important criterion of success in introducing voluntary savings mobilization from the public is its management. Providing savings facilities to millions of people throughout a large country and intermediating savings and loans is a major management challenge. It requires high level, accountable, experienced, open-minded, and dedicated managers who understand both finance and the microfinance market and who have experience in managing rapid growth.

### ***2. Training managers and staff to conduct demand research and to carry out demand studies.***

It is recommended that this activity be carried out with the help of MicroSave-Africa. The main questions that need to be answered are:

- What are savers presently doing with their savings (are they saving in cash in the house, gold, animals, raw materials, etc.?)
- What do they like about their present savings methods and what do they not like?
- What are their reasons for savings, and what forms of savings do they use for what purposes?

The answers to these questions represent the starting point of good product design. The institution's aim should be to attract a mix of clients including poor, lower-middle and middle-income people, as well as associations, organizations, and institutions that operate in the area served. People from all these groups should be interviewed during the demand research phase.

*Potential problems: Staff of microcredit organizations may be uncomfortable interviewing middle-income clients and heads of local organizations and institutions that are potential savers. If the interviewer is not able to talk easily with the respondent, the information is likely to be inaccurate.*

### ***3. Product design and pricing for the first pilot project***

The aim is not to have a large number of products (an approach that is too costly to manage on a large scale) but rather to have a few products that have been very carefully designed so that savers can customize their use of these products to suit their own needs.

- The first step is to train managers to design and price savings products.
- Once the institution's managers have been trained, trial products and services are designed for the pilot project branch. Information from the demand research should be used in designing a few simple products, including a tiered interest rate account that permits unlimited transactions and a fixed deposit account.

- Pricing products for the first pilot project is difficult because the extent of demand for the different products is not yet known. However, it is likely that the account permitting unlimited transactions will be popular – and also labor intensive. Therefore, labor costs should be carefully estimated and the estimates incorporated in the pricing. For such an interest-bearing current account, very small accounts should receive no interest, large accounts should receive market or near-market rates (depending on local competition) and there should be one or two intermediate interest rates for middle-level savers.
- Savers should be provided security, convenience (both in location and in opening hours), confidentiality, good service, and a mix of instruments providing different ratios of liquidity and returns.

*Potential problems: Too many products, and too low an interest rate spread. The purpose of the demand research is to learn the priorities for products and to design products that savers can mix and match for their own savings purposes. It is not to offer all products mentioned by potential savers.*

#### **4. Developing criteria for selecting the district where the pilot project is to be conducted and choosing the pilot site**

When developing criteria for the location of the first pilot project, a number of factors should be considered. The area offices in the district should have a track record of performance that falls in about the top 25 percent of BRAC's districts, but the district selected should not be among BRAC's very best. Thus the first pilot project should be conducted in an area with a good record and excellent potential. But the pilot area needs to face the same kinds of problems that are likely to be encountered in other areas later.

- The population in the pilot location should be reasonably typical of at least that of a major portion of the country.
- The location should be above average for population density and should have a mixed market economy.
- The location should be in an area with above-average infrastructure and communications.
- The pilot district should be not more than about 2 hours from the head office on dependable roads, as high-level managers must be able to be there frequently. But the pilot should not be conducted close to the head office.
- It is essential that there be exceptional regional and area office managers at the pilot location—experienced, skilled, hard-working, open-minded, and committed.
- The area offices in the pilot location will require sufficient space for increased numbers of clients and will need to accommodate more staff. Their spatial layout must allow for this expansion.

*Potential problems: Too many area offices in the first pilot. The first pilot is difficult, and it requires constant attention of high-level managers. It should be done only in one*

*district (although all area offices in that district can be involved unless the district is a very large one).*

#### **IV. The First Pilot Project**

A pilot project is essential for three main reasons:

- To determine whether the products that have been designed are in demand.
- Until the extent of the demand and the costs of different products (including labor costs) are known, only temporary interest rates can be set. Pilots are required to ensure that instruments are priced correctly, that operating costs are understood, that the interest rate spread enables profitability, that staff members are trained, and that information and communication systems work—before the products are offered widely and the institution attracts large amounts of unprofitable savings.
- To train managers and staff.

During the life of the pilot project, especially in the first months, head office managers must be available on a daily basis to troubleshoot and to monitor and analyze results.

The pilot project should be analyzed and evaluated on a monthly basis for six months (though changes can be made during that period if severe problems arise). At the end of six months, materials should be prepared for a careful review (see point 3 below).

##### ***1. Prepare the pilot project offices before starting to mobilize savings***

A partial check list:

- Have the head office managers and the area managers in the pilot district demonstrated that they are capable of running the pilot?
- Has the MFI's asset-liability management been revised to reflect the institution's new role as a microfinance intermediary?
- Have the transfer price mechanism and the cash management system been established appropriately?
- Have the reporting and bookkeeping systems been set up appropriately?
- Is the MIS appropriate and do the staff know how clearly to operate it?
- Is the record keeping system that will be used for monitoring the pilot project ready to start. This would include, for example, recording the number of savers and amount of savings by product; the account size distribution by product (crucial for establishing interest rates); data on withdrawals from phased-out compulsory savings and on how much of these funds and how many clients are opening in the new products. It would also include data needed for cost studies.
- Is the internal supervision process ready?
- Is the management and staff incentive system appropriate and in place?
- Is the pilot branch staff well trained in the products and services they will provide? Can they explain these well to potential savers?

- Are there enough cashiers? (Borrowers will stand on long lines; savers will not).
- Is the space in the area office suitable for rapid expansion, should this become necessary?
- Are transportation facilities adequate?
- Is the office neat and attractive, with information about the new products clearly posted?
- Are the security arrangements adequate?
- Are sufficient supplies of bankbooks, forms, brochures, and other supplies on hand?

***2. Operate the pilot project for six months, offering the new products and services and monitoring carefully the performance of the products, savers' reactions, the costs of providing the different products, and the quality of the loan portfolio.***

- During the first pilot project, monitoring and troubleshooting are essential. Do the clients understand the products? How well are the products performing? Are there enough staff to serve the clients? Is the MIS working properly? Is the space adequate? Are there sufficient bankbooks, forms, etc.? (The list of potential problems can be quite long).
- The first pilot project should provide on-the-job training to extra staff who will be able to help in case of high demand, who can then use their experience in the offices that will participate in the second pilot, and some of whom can become the nucleus of the "flying squad" – a small well-trained group that can be used during the second pilot and the expansion phase to troubleshoot and train as needed.
- Compulsory savings should begin to be phased out in the first pilot project so that BRAC can monitor the results with relatively little risk. One possibility would be to allow borrowers to withdraw perhaps a third of their compulsory savings. But this should take place only when the new products have been in operation for several months and the staff have been trained to explain to clients that they can move compulsory savings into any of the new savings products that they choose.

***3. Review and evaluate pilot results and revise products, pricing, services, operations, MIS, management and staff training and incentives, and others as necessary.***

At the end of six months of pilot project operation, the head office should carry out a careful review that includes:

- Analysis of the number of accounts and amount of savings by product.
- Evaluation of product design and the mix of products.
- Cost analysis and interest rate spread.
- Loan portfolio quality.

- Client satisfaction (a sample of savers should be interviewed).
- Transfer price system.
- MIS and communications.
- Asset-liability management.
- Operations and logistics.
- Management and staff capability and work load.
- Management and staff training and incentives.

If important information is missing, the pilot can be continued for another three months. Fewer than six months is not a long enough time for all the problems to emerge. But more than nine months for the first pilot project should not be necessary. Once the review is complete, all problem areas should be revised for use in the second-stage pilot.

After the review, the products, pricing, training, incentives, management and staffing, etc. should be revised, as necessary, for the second pilot project.

*Potential problems in the first pilot project: the most critical kinds of problems to look for are:*

- *Inadequate management.*
- *Deterioration in loan portfolio quality. This suggests that there is insufficient management and staff to operate the office as a financial intermediary.*
- *Too low an average account size. This indicates that more work needs to be done to mobilize savings from individuals with larger savings as well as organizations and institutions.*
- *The cost of savings is too high for institutional profitability. In addition to collecting savings from larger savers, interest rates may have to be changed and efficiency increased.*
- *Serious client dissatisfaction. The products will need to be reviewed and revised.*
- *Mismatched asset-liability structure (for example, long-term loans and short-term savings).*
- *Inadequate or irregular cash management (is there enough cash for savers who want to withdraw?).*
- *Poor staff morale. This suggests that staff are overworked or under-trained or have insufficient performance incentives. The problems need to be identified and changes made.*
- *Security problems and inadequate internal controls. These must be resolved before proceeding further.*
- *Inefficiency. Operational inefficiencies should be closely studied and changes made to improve efficiency.*

## V. The Second Pilot Project

The second-stage pilot has two main purposes:

- To test the revised products, pricing, operational changes, and any management and staff changes.
- To test the revised savings products in multiple environments that are different from that of the first pilot. The first pilot office should be continued alongside the second pilot offices..

### *1. Preparation for the second pilot project.*

Once the products have been evaluated and revised as needed for the second-stage pilot, the new pilot branches need to be selected. While the first pilot must be conducted fairly close to the head office, the districts where the second pilot will be carried out can be further away and should represent a range of economic, geographic, agricultural, and demographic conditions (including coverage of both urban and rural locations and selection of areas that have a range of competition). But all selected offices should have experienced managers with above average performance records and an interest in learning and implementing new approaches, products, and services.

Once the districts and the BRAC offices are selected, managers and staff of all the area offices and regional offices that will participate in the second pilot must be trained.

*Potential problems: A mismatch between the number of pilot area offices selected and head office management capacity. The second pilot requires substantial head office management and coordination.*

### *2. Implementation of the second-stage pilot in multiple branches in different environments.*

Implementation of the second-stage pilot is similar to that of the first pilot, except that it requires much more coordination. In each office careful records must be kept of the performance of the revised products, cost analysis must be carried out, and a careful eye must be kept on both loan portfolio quality and what happens when compulsory savings are withdrawn from borrowers' accounts.

The second pilot could be a good time to introduce both a savings program for children in BRAC schools and the stamp savings methodology. (Introducing these innovations in the first pilot might be too much of an overload, but they should be tried out before the savings program is expanded to all area offices).

*Children's savings in BRAC schools.* The program might look something like this.

- Each child in a BRAC school would be given a contractual savings account with perhaps 50 taka in the account. Some part of the savings (to be determined) could be withdrawn when the student leaves the BRAC school. At that time a different type of account could also be opened, as appropriate for the account holder's needs.



- The schoolteachers would keep track of the children's accounts and make the deposits for them.
- The schools would arrange occasional (perhaps 3 times a year) income-earning activities for their students. The income would be divided among the children and each would deposit all but a very small percentage in his or her account.
- The teacher would hold occasional evening meetings for parents and students and a representative of BRAC's area office would come and discuss BRAC's microfinance products and services with the parents and students.
- Parents and teachers would be encouraged to open their own savings accounts.

This program could have the following advantages:

1. Rapid outreach to over a million savers in the BRAC schools.
2. Some parents and teachers would also open accounts.
3. Low cost except for the funds for the initial deposits.
4. Microfinance would be part of the children's educational experience at a formative age.
5. Many of these children would probably keep accounts with BRAC when they become adults.

*Savings stamps.* If the regulatory authorities agree, BRAC savings stamps could be issued and sold by BRAC area offices and perhaps by local shops as well. Savers would purchase stamps (available in different denominations) and paste them in a BRAC stamp book, which could be provided free or for a small fee. When the saver's first book is full, he or she would take the book to the BRAC area office and open an account (in any suitable savings product). The stamps would be cancelled and their value credited to the account. The saver would be encouraged to keep some of the money in the account. Subsequent books would be deposited in the account in the same way.

### *3. Evaluation of the second pilot project.*

The same steps should be followed as in the first pilot project, but because of the significantly larger number of offices involved in the second pilot, this will be a more comprehensive evaluation involving assessment of products, services, and pricing and revision as necessary.

If the evaluation finds that the savings products are popular and are priced for institutional sustainability, and that only small changes are needed, then plans should be made for expanding the savings program gradually to all districts (with such revisions as may be needed). *If, however, there are serious problems with management, products, product delivery, efficiency, costs, staff, or loan portfolio quality, then expansion should be held up until the second pilot has demonstrated that its products are well liked and delivered cost effectively, and that the intermediation is well managed.*

*Potential problems in the second pilot: the issues and problems are more complex than in the first pilot. Head office managers must now analyze far more data than in the first pilot, troubleshoot quickly where needed over a wide area, and focus on understanding the reasons for major problems and possible significant differences in performance among the pilot offices and districts. But these are lessons that have to be learned before the products are rolled out to all BRAC's area offices. If the school and stamp programs are implemented, these would add to the coordination challenges.*

## VI. Gradual Expansion to All BRAC's Area Offices

The move from the second pilot project to the stage where savings products and services are expanded to all area offices involves two main activities. The first is the training of the trainers and head office managers. The second focuses on the training activities and logistics of the actual expansion in the regions.

### *1. Training the trainers for the expansion phase.*

At this stage in its savings effort, BRAC should have a core group of head office managers, regional and area office managers, trainers, staff, and a flying squad – all of whom have been involved in the pilot projects and are knowledgeable about savings products and pricing and the process of financial intermediation. But the rest of BRAC's managers and staff are likely to know relatively little about savings and will need to be brought up to speed before the rollout takes place.

Experience elsewhere has shown that preparation of a casebook to be used for teaching purposes is extremely useful. The casebook contains examples of ways that savings was mobilized from different kinds of savers in the pilot projects: how potential savers were contacted, what questions they had, what methods were used, what problems were encountered and how these were resolved (and if not resolved what were the issues and how could they be resolved in the future?), and what products the savers chose and why.

*Potential Problems: Inadequate training of the trainers. This can have serious negative effects quickly, as weak trainers will be unable to train accurately or effectively when the program is expanded to the regions.*

### *2. Gradual expansion to all area offices.*

Expansion should take place gradually by region. Managers and staff in all regions will have to be trained, attitudes may have to be changed, and much new material concerning products, operations, client relations, logistics, etc. will have to be learned by all managers and staff. And training and troubleshooting by skilled (and scarce) managers needs to accompany the rollout in every region.

*Potential problems: The most serious is the common tendency to rush the expansion process. This can result in major problems, not only for savings but also for the quality of the loan portfolio.*

## VII. The Environment for BRAC's Savings Mobilization from the Public

The views below emerged from a discussion carried out for about 8 hours over three days with about 12 senior managers who are responsible for BRAC's various financial activities (senior microfinance managers of the BRAC NGO and BRAC Bank's senior SME managers). A substantial portion of the discussion concerned the likely environment for microfinance savings and intermediation in Bangladesh and at BRAC.

### *Country environment*

- Macroeconomic and political stability are at a level that is generally suitable for the introduction of voluntary savings from the public at this time.
- A suitable regulatory framework and a license for mobilizing public savings are needed for BRAC to move ahead.
- Public supervision is needed, but the type and degree would need to be worked out with the Bangladesh Bank (BB). At a minimum BRAC would report regularly to BB, and be externally audited. One possibility might be for BRAC to supervise its area offices on behalf of BB, with BB having the right to exercise its own supervisory authority at any time deemed necessary.

### *Institutional environment*

- BRAC has a strong comparative advantage in its governance and management.
- BRAC has an excellent performance record and holds a high reputation throughout Bangladesh; both these factors should have an important positive effect on its savings mobilization.
- There is a large, well-trained, and committed group of management and staff. However, new kinds of training and possibly new incentives will be required.
  - To change concepts and attitudes to those appropriate for a financial intermediary.
  - To learn the market for savings, including new kinds of clients for BRAC.
  - To develop, price, and deliver appropriate savings products.
  - To train the trainers.
- Having all its offices computerized, BRAC has a strong comparative advantage in its MIS system. But aspects of the system will need to be changed to accommodate the requirements of savings from the public – which is characterized by irregular and largely uncontrollable amounts of deposits and withdrawals.
- Mobilizing voluntary savings from the public will require new kinds of planning and logistics with regard to such matters as security, internal controls, financial intermediation, office space, reporting, cash management, and so on.

Overall there seemed to be general consensus that, while becoming a financial intermediary will be a lengthy and difficult effort, BRAC has strong comparative advantages in its leadership, infrastructure, experience in managing rapid growth, knowledge of the microcredit market, and its nationwide reputation – and that these will stand BRAC in good stead as it begins to mobilize savings from the public and develops into a microfinance intermediary.

## APPENDICES

Appendix 1: Eight Principles of Savings Mobilization for Commercial Microfinance

Appendix 2: Risks of Introducing Voluntary Savings from the Public

Appendix 3: 20 Steps to Introduce Voluntary Savings from the Public in Regulated Microfinance Institutions

Appendix 4: Stages of Development and Performance at BRI's Unit Desa Savings Mobilization Program.

## **Appendix 1:**

# **Eight Principles of Savings Mobilization for Commercial Microfinance**

**Eight Principles of Savings  
Mobilization for  
Commercial Microfinance**

**Marguerite S. Robinson**

**World Council of Credit Unions**

**Washington, D.C.**

**5 November 2002**

# *1. Poor People Save*

- Poor people in developing countries save in a variety of forms.
- The job of the MFI is not to teach them to save.
- It is to develop products and services appropriate for savers' needs.

# The Value of People's Savings

“The value of savings among the poor is, in fact, immense—forty times all the foreign aid received throughout the world since 1945. But they hold these resources in defective forms...Because the rights to these possessions are not adequately documented, these assets cannot be readily turned into capital.”

-- Hernando de Soto



## Capital – Dead and Alive

- De Soto calls the legally unrecognized assets of the poor “dead capital” – capital that cannot create capital.
- Savings accounts are often the first legally recognized assets that poor people can acquire. These are live capital – which can create capital.

## *2. Preconditions for Mobilizing Savings from the Public -1*

### *Country Environment*

- Reasonably enabling macroeconomy and some degree of political stability
- Adequate regulatory environment
- Capacity for public supervision of MFIs that take deposits from the public

# *Preconditions for Mobilizing Savings from the Public -2*

## *Institutional Performance*

- Accountable ownership
- Effective governance
- Strong, committed management
- Track record of financial self-sufficiency
- Transparency
- Well-trained and motivated staff

### *3. Change in Attitude Required*

- For credit the MFI selects, and must trust, the client.
- But for savings it is the client who selects, and must trust, the MFI.
- Potential savers need to know about the institution and why they should trust it.
- No more yellow pajamas!

# What Savers Want -1

- Security
- Convenient locations and opening hours
- Access to an appropriate product mix, including an account with unlimited transactions
- Confidentiality
- Helpful, friendly service

## What Savers Want -2

- Returns
- Potential access to loans
- **These are components of a package needed for large-scale savings mobilization from the public.**
- **They are not a menu from which the MFI can choose!**

## *4. To Serve the Poor, Savings is Collected from the Public -1*

- Can financial institutions mobilize large-scale voluntary savings from the poor profitably?
- Not if they confine their savings services to the poor. The transaction costs for large numbers of tiny accounts are too high for profitability.

## *4. To Serve the Poor, Savings is Collected from the Public -2*

Public savings mobilization:

- Raises the average account size so MFIs can mobilize savings profitably
- Provides a diversified deposit base
- Staggers the timing of withdrawals
- Can finance an expanding microloan portfolio



## *5. Savers Cannot be Turned Away - 1*

- More low-income people typically want to save at any one time than to borrow.
- Mature MFI intermediaries tend to have more savings accounts than loans.
- MFIs entering savings must prepare for a substantial, rapid – and largely uncontrollable -- increase in the number of their clients.

## *5. Savers Cannot be Turned Away - 2*

Accommodating a large increase in clients usually requires significant improvements and additions in:

- Management – of a larger institution, now a financial intermediary
- Staff, space, training, transportation
- MIS, reporting, accounting, internal audit
- Computers, furniture, supplies

## ***6. Savings is not only a source of funds – it is also a liability - 1***

- MFIs need to pay careful attention to protecting savers' funds from:
- Poor management
- Internal corruption
- Loan defaults
- Theft

## *6. Savings is not only a source of funds; it is also a liability - 2*

Accessing public savings requires:

- A corporate culture of accountability
- New security measures
- Constant attention to loan portfolio quality
- Effective and timely internal supervision

## ***7. An Appropriate Product Mix***

MFI's should offer *a few* well-designed products that savers can customize for their own use.

- A current account, a fixed deposit account, and 1-2 others to start.
- Too many products make branch management too complex and expensive.
- A few products designed for use in different combinations for different purposes are essential.

# Products Tend to be Overemphasized

An unfortunate recent trend is a “Have products, will roll” approach to savings mobilization.

Appropriate products are crucial. But so is the ability to deliver them, which includes:

- High quality, well-trained, accountable personnel
- Appropriate, well administered MIS
- Effective asset-liability management, liquidity management, cash management, transfer pricing
- Helpful, friendly attitude toward clients
- Efficiency (no long lines)

## ***8. Sequencing is Crucial - 1***

**MFIs beginning savings mobilization from the public must sequence their introduction appropriately**

- 1. Learn international experiences**
- 2. Appropriate macroeconomic conditions, regulatory environment and supervision capacity**

## ***8. Sequencing is Crucial - 2***

### **3. Institutions must be financially sound**

- clear ownership**
- good governance**
- a record of high repayment**
- profitable**
- appropriate capital adequacy**



## *Sequencing is Crucial - 3*

- 4. Full-time high-level management resources made available**
- 5. Conduct demand research**
- 6. First pilot project**
- 7. Pilot project assessment and revisions**
- 8. Second pilot project if necessary**

## *Sequencing is Crucial - 4*

- 9. Monitor pilots and train trainers for expansion**
- 10. Expand gradually to all branches, training staff in each location**
- 11. Systematic approach to savings mobilization and staff incentives for performance**
- 12. Market penetration**

# Conclusions

- Savings mobilization from the public should be undertaken only by well governed and managed, financially self-sufficient institutions.
- Large-scale microfinance intermediaries are complex organizations, requiring high-level, financially experienced, dedicated managers.
- Successful savings mobilization from the public is not a matter of adding a few products. *It changes the institution fundamentally.*

## **Appendix 2:**

### **Risks of Introducing Voluntary from the Public**

**Introducing Voluntary Savings from the Public  
in Regulated Microcredit Institutions: What are the Risks?**

by  
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Becoming a microfinance intermediary and mobilizing voluntary savings from the public is a complex effort, and it is not possible here to analyze all the risks. Therefore I have selected risks that I think are among the most important. It should be noted that many of the most common and serious risks are related not to products – as is often assumed by about-to-be-regulated microcredit institutions – but rather to ownership, management, and institutional capacity to deliver products.

## **I. COUNTRY RISKS**

*1. Is there a reasonably enabling macroeconomy, some degree of political stability and political will, and sufficient population density, monetization, and basic infrastructure?*

Risks will generally be high if savings are mobilized from the public by newly-regulated institutions or institutions new to the microfinance market:

- During periods of severe economic destabilization.
- In emergency or immediate post-emergency environments.
- In areas characterized by very low population density, a low level of monetization, lack of basic infrastructure, unstable populations, or severe security problems.
- In areas without a functioning financial system.
- In areas that are politically highly unstable, or where political interference in microfinance can be expected.
- In areas without an appropriate, functioning legal system.

*2. Is there a reasonably adequate regulatory environment?*

Commercial institutions that provide microfinance, intermediating between credit and savings mobilized from the public, need appropriate regulations (or deregulations) in a number of areas, including:

- Interest rates.
- Capital requirements for opening an institution.
- Capital adequacy ratios.
- Accounting and audit standards.
- Requirements for opening branches.
- Reporting requirements.

Without such regulations (that are well-implemented), institutions can fail and savers' money can be put at risk

### *3. Are microfinance intermediaries collecting public savings publicly supervised?*

To be financially sustainable, microfinance institutions must mobilize savings from the non-poor as well as the poor – to raise the average account size to a level at which savings can be collected profitably, while also serving large numbers of poor savers with small accounts.

For the protection of their customers, especially savers, financial institutions that mobilize voluntary savings from the public should be publicly supervised. If this is not the case, both the savers and the institution are at risk.

- This does not mean relaxing supervising standards. It means applying high standards in ways that are appropriate for microfinance institutions.
- It also means ensuring that the supervisory body is able to monitor these institutions effectively.

However, it should be noted that in many countries today, the capacity for microfinance regulation and supervision and commercial microfinance institutions are evolving simultaneously.

### *4. Subsidy dependence: does the country have an appropriate poverty alleviation strategy?*

If the county has massive credit subsidies from the government and/or donors, and if credit is supposed to reach the extremely poor, there is a high risk that subsidized microfinance institutions will not succeed in commercial microfinance intermediation. There is little incentive to mobilize voluntary savings if large amounts of cheap money are delivered regularly to the microfinance institution. Bangladesh is a case in point. There, a weak banking system combines with massive credit subsidies to ensure that, with very few exceptions, the demand for voluntary savings services among poor savers is left unserved.

- *Credit* is appropriate for the creditworthy among the economically active poor – people with the ability to use loans and the willingness to repay them.
- Subsidized poverty alleviation tools are appropriate for the very poor who have prior needs – tools such as food, shelter, medicine, skills training, and employment. When such people become economically active, they will then be able to make use of commercial microfinance institutions.

But when subsidized credit is provided to extremely poor people who cannot use it effectively, and to economically active poor people who could pay commercial interest rates, the conditions are set for:

- Large unmet demand from poor savers.
- Large unmet demand from poor borrowers (because credit subsidies are rationed).
- The absence of commercial microfinance intermediation.

*Institutions that go ahead despite severe country risk (and are not stopped by regulatory authorities because of weak financial and regulatory systems) face high risk.*

## II. INSTITUTIONAL RISKS

### *1. Does the institution have an appropriate ownership and governance structure?*

If the answers to the questions below are not positive, the risks to savers who entrust their savings to microfinance intermediaries (and to the institutions) can be substantial.

- Is there clear, accountable ownership of the institution, and does the institution have a transparent structure of responsible governance?
- Have the owners and the board members passed an internationally accepted ‘fit and proper’ test?
- Does the institution have a clearly stated mission and realistic goals, and are its owners and board capable of, and committed to, implementing these?

### *2. Does the institution have managers who have skills and experience in financial intermediation among numerous small sub-branches, and who have substantial knowledge of microfinance demand and clients?*

Few microfinance institutions meet these criteria. But all financially self-sufficient commercial microfinance intermediaries meet them.

*The risks of introducing commercial microfinance intermediation without skilled, knowledgeable management are so high that an institution without such management should table plans for providing microfinance intermediation until it has the necessary managers in place and thoroughly familiar with the institution and the country environment.*

Management risks can arise in different ways in different kinds of institutions. But the risks share the same components.

- *NGOs that become regulated institutions* usually do so to mobilize public savings and become financial intermediaries. They have a tendency to be characterized by diffuse ownership, to bring onto their new boards unqualified members of their NGO boards, and to move managers without financial skills from the NGO to the regulated institution. This is a very high risk scenario (and often difficult to turn around).
- *Credit unions and cooperatives* usually have experience with savings mobilization from various kinds of savers, as well as experience in lending to borrowers. But management and default risks can be high in some member-owned institutions where the most influential members are (de jure or de facto) both the institution's managers and its largest borrowers. The result tends to be high loan defaults. Some member-owned institutions are well managed, but many are not. Management risk can vary greatly from one institution to another.
- *Regulated financial institutions going downmarket* are often pushed into microfinance by intense competition for prime customers. And they may be pulled into microfinance by the profits that can be made. Banks, finance companies, and other regulated nonbank financial institutions generally have experience in financial intermediation, and their managers have financial skills. But they usually do not know the microfinance market. And they typically do not understand that it is, in some important ways, a different market from that which they currently serve – in products, pricing, management and staff recruitment and training, etc. Banks whose managers do not take the time and effort to learn international best practices in microfinance face substantial risk in entering microfinance intermediation.

The provision of simple, appropriate products to a large number of microfinance clients spread over a large area, with profitable intermediation between savers and borrowers, may look simple to an observer of a sub-branch with a small staff. But large-scale microfinance is a complex effort at the head office, and it requires high-level, accountable, experienced, open-minded, and dedicated managers who understand both finance and microfinance demand. Without such managers the risk is high, regardless of institutional type.



**3. Does the institution have appropriate technology and management information systems?**

- Does it have an appropriate management information system that works well?
- Does it have the technical capacity to produce transparent, accurate reports that can be effectively used by managers in a timely manner?
- Are its managers able to use international best practice tools effectively for business planning and financial modeling, accounting and auditing, costing and pricing, etc.?

If not, the technical risk can be high.

**4. Does the institution have clear and appropriate human resource services?**

- Does the institution have a developed career path for employees?
- Does it have training programs for managers and staff geared toward knowledge of clients, financial skills, responsibility, and accountability?
- Is its organizational structure adequate for the demands of large-scale microfinance intermediation (or is such a structure being put in place?)
- Are there performance-based incentives (monetary incentives, promotion procedures, and honorary awards)?

**5. Does the financial institution have a strong performance record and a good reputation?**

Microfinance institutions should have a strong track record of accountable ownership and governance, effective and efficient management, transparent reporting, accounting methods that adhere to international standards, and a track record of profitability and financial self-sufficiency *before* they are licensed to collect savings from the public and intermediate these. Such institutions should be financially solvent, with a high rate of loan recovery. Otherwise, there is considerable risk of institutional failure and loss of savings by clients.

**6. Can the institution meet substantial new challenges, and is it capable of absorbing many new clients quickly, safely, and profitably?**

Two examples of risks that are often not thought about (until too late):

- *Capacity for serving the public.* Microfinance institutions serving the public can control the number of loans they give, but they cannot control the number of savers they serve. If an institution's products and services are attractive, large numbers of savers may open savings accounts at the institution soon after it opens its voluntary savings services. In a few months the number of clients can double; in a few years it can have trebled or more.
  - Can the institution manage this rapid, and to a large extent uncontrollable, expansion?
  - Can the institution obtain sufficient qualified management and staff; internal controls, audit, and supervision; training; information technology; space; computers, furniture, and the like?
  - Can it handle asset-liability management, security, cash management, accounting and reporting, and so forth?
  - Can the institution keep its loan portfolio quality high while introducing voluntary savings to the public?
  
- *Serving new kinds of clients.* Newly-regulated microfinance institutions taking public savings will need to collect savings not only from the poor, but also from better-off individuals and businesses, as well as from associations and institutions that are based near their branches. Banks going downmarket will have to learn the microfinance market. In both cases, the institution must learn to serve clients who are different from their traditional customers.
  - Does the institution know how to design and deliver products for a wider variety of clients than they have previously served?
  - Do their staff members know how to approach and talk with these clients?
  - In the case of institutions that have previously served only poor groups of women, can the staff explain the products and services clearly and effectively to potential clients who are men? To middle-income clients? To organizations and institutions operating in their service areas?
  - Larger savers tend to demand individual loans. Has the newly-regulated institution designed individual loan products, and do their staff know how to assess the creditworthiness of individual borrowers and their enterprises? Do they know how to collect individual loans?
  - And in the case of banks and other regulated institutions serving up-market clients, have they learned the microfinance market, products, pricing, etc. And are they willing to change their management and organizational structure to accommodate large numbers of microfinance clients?

Overall, does the institution have the will, the knowledge, the resources, and the commitment to undertake the major institutional changes – in management, organization, methodology, and attitude – that are needed for large-scale microfinance intermediation?

*The primary institutional risk is that the microfinance institution looks at itself through rose-colored glasses. An institution that does not take a hard objective look at itself (and*

*obtain outside ratings), and analyze carefully whether it is ready to mobilize and intermediate savings from the public, faces substantial risk if it enters commercial microfinance intermediation.*

### **III. RISKS IN PRODUCT DESIGN, PRICING, AND PLANNING**

Of the four general types of risks discussed here, risks related to product design, pricing, and planning are the easiest to manage. Successful microfinance products are not difficult to design, but they need to be planned, priced, and tested by people skilled and experienced in both demand research and financial analysis.

Of course if an institution promotes a product that requires a minimum balance of \$1,000, pays below-market interest, and limits withdrawals to one per year, it is unlikely to attract many poor savers. But savers around the world want the same things: security, convenience, confidentiality, good and friendly service, and a choice of a few products that offer different ratios of liquidity and returns – so that a saver can customize use of the products to meet his or her own demand. Institutions can easily design such products and test them for popularity and profitability, if they know how.

*1. Does the institution know how to conduct demand research among a mix of clients (both genders, different income levels and occupations, different ethnic groups, etc.)?*

The risk is that if the interviewers are not experienced and comfortable talking with respondents, the information collected is likely to be inaccurate (and the interviewers are unlikely to know this).

*2. Is the institution prepared to set a spread between lending and savings interest rates that enables institutional profitability (and can it handle political fallout from critics on this issue?)*

If not, the risk is either that the institution is unprofitable or that it becomes politicized (or both).

*3. Have the managers and staff who will be involved in the pilot project been trained specifically for their new activities?*

Risks commonly arise from skipping this step or from in-house training with unqualified trainers.

*4. Does the institution have appropriate criteria for selecting a geographical site and a branch for a pilot project to test its first savings product(s) offered to the public? And do its managers understand how much scarce high-level managerial resources must go*

*into a successful pilot project. (In my experience, very few institutions meet these criteria).*

The risk here is that the institution does not know how to select a pilot site, how to train the staff of the pilot branch, and how to manage the pilot project. And an even greater risk is that owners, boards, or CEOs require many simultaneous pilot projects at the beginning – which cannot be effectively managed (and may not only fail but can also result in a decline in the quality of the loan portfolio).

#### *5. Are there too many savings products planned for the pilot project?*

Neophytes in microfinance intermediation sometimes think that to be successful they need to turn each suggestion uncovered in the demand research into a product. The purpose of the pilot project is to learn the priorities for products, to price them for profitability once there are hard data on account size distribution and labor costs, and to train managers and staff. The purpose is not to supply all (or even most) of the products requested by potential savers. It is too expensive to administer a large number of products, especially in the beginning. What is necessary is to design a mix of 3-4 products carefully, so that clients can customize their use of the products to suit their own needs.

The risks are that there are too many savings products that are costly to manage and to administer, and that there is too low an interest rate spread. The institution must be willing to raise interest rates on loans if this turns out to be necessary. If the institution offers too many savings products and is unwilling to make needed changes in its loan products (e.g., changing interest rates, providing individual loans), there is considerable risk that its microfinance intermediation may not be profitable.

*The main risks in designing a mix of savings products are that the demand research has been faulty and the products are not attractive to savers; that the products have not been priced for profitability; that there are too many products offered; and that the large effort required for the savings work results in a decline in the quality of the loan portfolio.*

#### **IV PRODUCT DELIVERY RISK**

Institutions beginning commercial microfinance intermediation can easily fail in the delivery of savings products and in the accompanying financial intermediation required. They fail because they do not have the resources and skills to manage the product delivery or the financial intermediation, and because they do not follow an appropriate sequence of activities. Thus the coordination required among managers, staff, internal supervisors and auditors is not in place. As a result, financial management, organizational

structure, information systems, training and incentive programs, internal supervision, etc. may be inadequate, inefficient, not timely, out of sequence, and ineffective.

Both at the pilot project stage and later at the rollout, there are a number of risks. Most are directly related to risks mentioned earlier, but there is, at the product delivery stage, a risk of delivery breakdown because of a combination of individual types of risks (management risk, technical risk, human resources risk, product design risk etc.).

In my experience, most financial institutions entering commercial microfinance intermediation have difficulties with many of the delivery issues raised below, and the resultant risks can be high. Some examples:

### *1. Financial.*

- Has the institution's asset-liability management been revised to reflect the new circumstances?
- Have the transfer price mechanism and the cash management system been established well?
- Have the reporting and bookkeeping systems been adequately set up?
- Is the average account size large enough for institutional profitability?
- Is the interest rate spread adequate, and is the institution profitable?

### *2. Human resources*

- Have the head office and branch managers demonstrated that they are capable of running the pilot and the rollout of the new products?
- Is there an effective, ongoing training system that trains all managers and staff in the institutions's new approach to commercial microfinance intermediation?
- Do the staff know clearly how to operate the information systems?
- Is the internal supervision process working satisfactorily?
- Is an appropriate management and staff incentive system in place?
- Do the staff understand the different products, and can they explain them clearly to clients?
- Are there enough cashiers? (Borrowers will stand on long lines; savers will not).
- Is the information technology management and staff adequate?
- Is staff morale good?

### *3. Operations and logistics.*

- Is the management information system appropriate for the institution's needs?
- Is the space in the branch suitable for rapid expansion?
- Are transportation facilities adequate?

- Is the branch neat and attractive, with information about the new products clearly posted?
- Are the security arrangements adequate and working?
- Are there sufficient supplies of bankbooks, forms, brochures, and other supplies on hand?
- Is the reporting transparent, accurate, and timely?

#### *4. Monitoring and analyzing results.*

- Is the loan portfolio quality being carefully monitored to make sure that savings is not taking so much staff time that the loan portfolio declines?
- Are careful cost analyses of the various products being carried out?
- Are staff talking to savers to get a first-hand view of their views about the new products and services?
- Is the management information system working as needed?
- Are the operations efficient?
- Are marketing efforts appropriate?

Many microfinance institutions do not meet even half these criteria when they propose to start mobilizing savings from the public. And these are only examples of capacities that institutions need to have; there are many others.

If institutions cannot deliver the products and services they plan, the risks of failure can be high. Some warning signals to watch for:

- *Inadequate management and coordination.*
- *Inadequate internal supervision.*
- *Insufficient training for managers and staff.*
- *Inappropriate incentives. (If incentives are provided only for savings, the loan portfolio can decline quickly, as staff turn their attention to finding savers).*
- *Security lapses and problems.*
- *Client complaints.*
- *Decline in the quality of the loan portfolio.*
- *Mismatched asset-liability structure (for example long-term loans and short-term savings).*
- *Problems in account size distribution (are there enough funds in large accounts so that the average account size is sufficiently large for profitability despite large numbers of small accounts?).*
- *Erratic cash management (is there enough available cash for savers who want to withdraw?).*
- *Overworked staff with low morale.*
- *Publicity about savings products that is too early and too widespread (may bring more savers than management can handle).*

- *Rushing the rollout. Once the pilot project (and subsequent pilot projects, as needed) have been analyzed and rollout plans have been made, the rollout to all branches should proceed gradually, region by region. Training and troubleshooting by skilled (and scarce) managers needs to accompany the rollout in every region. The most serious (and most likely) problem is that the board or CEO tries to cut the process short to finance a growing loan portfolio. This is a common tendency that carries heavy risks, not only for savings but also for the quality of the loan portfolio.*

The four types of risks discussed here are arranged in sequential order. Thus if the country risk is too high, the microfinance institution cannot or should not start mobilizing savings from the public or intermediating until the country conditions are improved. Similarly, if the institutional risk is too high, the microfinance institution needs to work first on upgrading its ownership, governance, management, and performance.

The product design and delivery risks are often not taken as seriously as country and institutional risks. The product risk is low if the institutional risk is low (i.e., if experienced, well-trained managers are designing, pricing, and planning the products).

But the delivery risk, which is often ignored, can be high even when other types of risk are low. This is because even the best microfinance institutions are typically not accustomed to large-scale financial intermediation (among what may be a greatly increased number of customers) through many branches located far apart. This is a complex coordinating effort, requiring very high-level management skills. Delivery risk is high for most institutions beginning to collect savings from the public and entering commercial microfinance intermediation for the first time.

## **Appendix 3:**

# **20 Steps to Introduce Voluntary Savings from the Public in Regulated Microfinance Institutions**



## 20 Steps to Introducing Voluntary Savings from the Public in Regulated MFIs<sup>1</sup>

1. Become familiar with international best practices in mobilizing savings from the public by MFIs. If possible, visit regulated MFIs that successfully intermediate between borrowers and savers.
2. Review the country's current macroeconomic and political conditions, regulatory environment and supervisory capacity to see if country preconditions are met.
3. Examine the institution to see if it is ready. Does it have clear ownership; committed and financially knowledgeable governance; high-quality, financially experienced management; skilled, motivated staff; and a record of high loan repayment. Is it efficient? Does it have sufficient capital adequacy? Is it financially self-sufficient, with a track record of excellent performance for at least 3 years?
4. Conduct demand research. What are savers presently doing with their savings? What do they like about their present savings methods and what do they not like? What are their reasons for savings and what forms of savings do they use for what purposes?
5. Develop criteria for pilot project site and select branch for pilot project.
6. Identify trainers to train the institution's trainers. Train the trainers, and the head office, regional office, and branch office managers and staff who will be involved in the first pilot project.
7. Design and price products and services for the pilot project. Develop a performance-based staff incentive system.
8. Prepare logistics for pilot project site (building renovations, space use, MIS, staff, transportation, cash management).
9. Conduct first pilot project.
10. Assess pilot results and revise products, pricing, services, operations, MIS, staff training and incentives, etc. as necessary.

<sup>1</sup> From Robinson, Marguerite S., *The Microfinance Revolution*, Volume 3 (forthcoming 2004).

11. Select branches in different kinds of environments for second-stage pilot project.
12. Train managers and staff of new pilot branches.
13. Implement and evaluate second-stage pilot. Monitor and revise products, services, and pricing as necessary.
14. Train trainers for expansion phase. Train all managers for expansion to all branches.
15. Expand <i>gradually</i> to all branches, training managers and staff in each location. Do not rush the expansion phase (a common tendency that can have seriously negative results, not only for savings but for loan portfolio quality as well).
16. Develop a systematic approach to savings mobilization for full market penetration of the service area of each branch.
17. Train managers and staff in new systematic approach to identifying savers and mobilizing savings.
18. Review management and staff incentives and revise as necessary..
19. Revise training and operations as necessary and gradually introduce the systematic approach to all branches.
20. As the market becomes penetrated, savings is likely to overtake lending; it then becomes important to investigate strategies for investing excess liquidity.

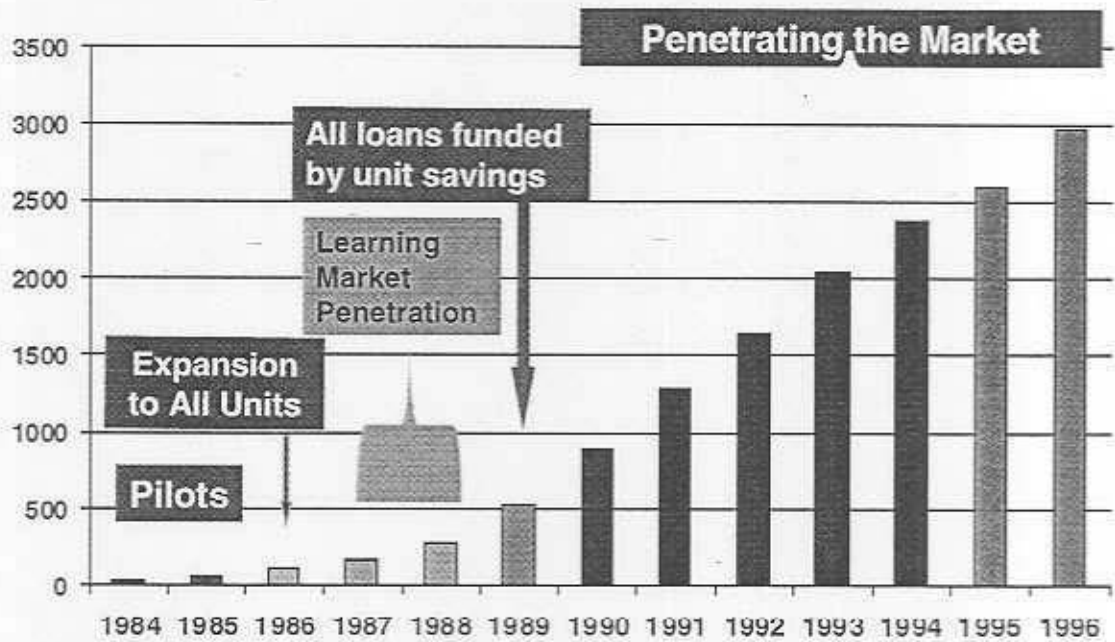
## **Appendix 4:**

### **Stages of Development and Performance at BRI's Unit Desa Savings Mobilization Program**

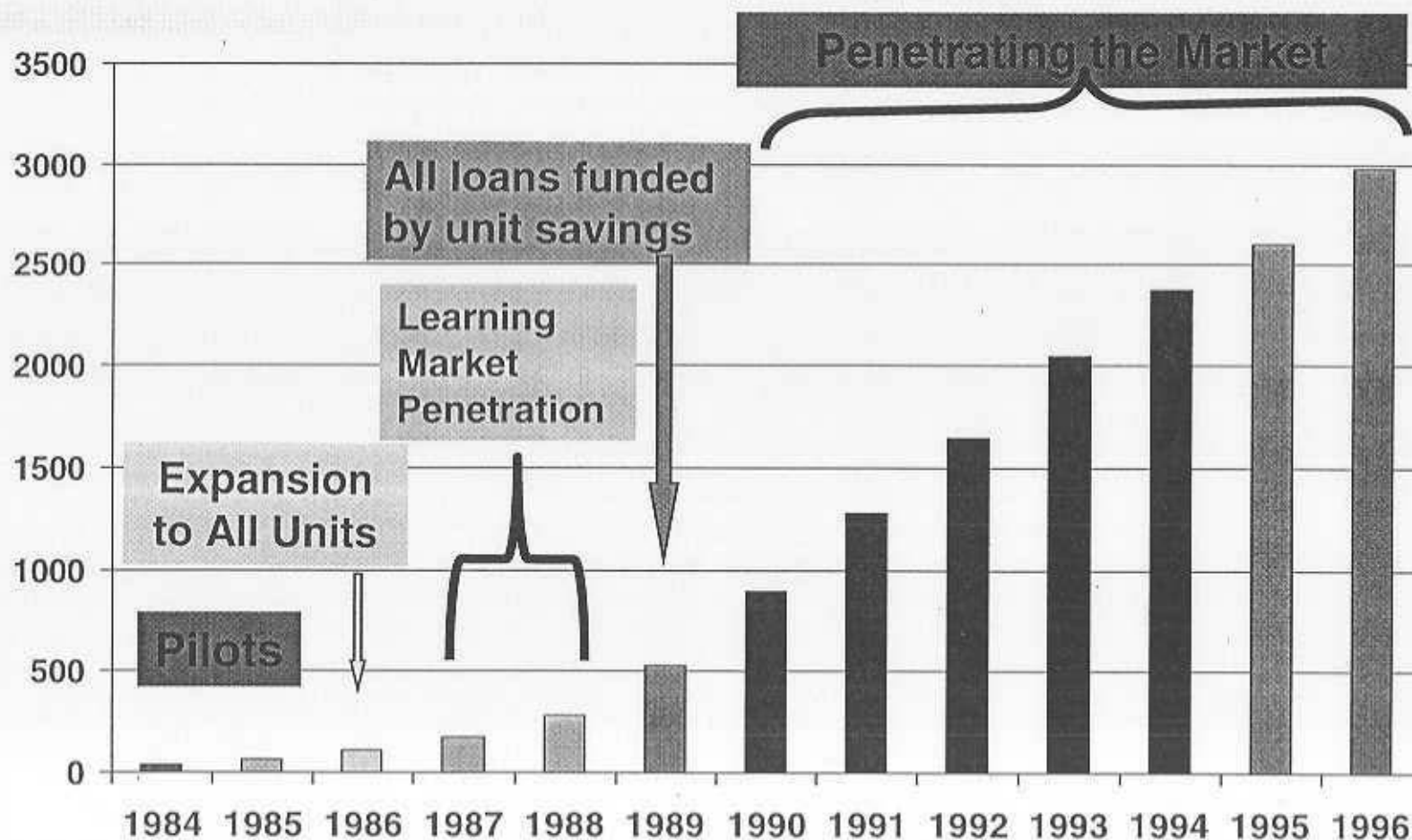
# Stages of Development and Performance

in BRIs Unit Desa Savings Mobilization Program

1984-1996 (in millions of US dollars)



# Stages of Development and Performance in BRI's Unit Desa Savings Mobilization Program 1984 - 1996 (in millions of US Dollars)



## BRI Unit Desa Savings and Deposits, 1996-2001

<i>Indicator</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>
<b>Value of savings and deposits (billions of rupiah)</b>	7,092	8,837	16,146	17,061	19,115	21,991
<b>Number of savings accounts (thousands)</b>	16,147	18,143	21,699	24,236	25,823	27,045