Low Income Lives

MicroSave
Market-led solutions for financial services

# The Relative Risks to the Savings of Poor People[1]

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## Background

Increasingly, Microfinance Institutions (MFIs) have come to recognise the need to provide savings services – both as a much valued service to their clients, and as a long-term source of capital. This has led to growing interest in savings, Vogel's (1984) "forgotten half" of microfinance. As a result of the new attention to savings services, a great deal of time and energy is being spent by Central Banks, donors, consultants and MFIs on developing systems for regulating and supervising MFIs offering savings services.

1. This Briefing Note was developed on the basis of a full paper by the same name available on ***MicroSave's*** website: www.MicroSave.net under Study Programme section.

Central Banks' motivations to regulate MFIs (or indeed any other financial institution) revolve round two primary aims:

1. To protect the integrity of the country's financial system (i.e. to guard against "systemic risk"), and
2. To protect depositors within a context of asymmetric distribution of information (i.e. to guard against depositors losing their savings in the event of the failure of financial institutions).

In most countries, (with the exceptions of Indonesia, Bangladesh and possibly Bolivia) MFIs simply have not reached the scale or achieved the breadth and depth of market penetration to pose any systemic risk. It is therefore the laudable desire of Central Banks to "protect depositors" that is the credible rationale for their efforts to regulate and supervise.

Poor people have limited access to formal or semiformal financial services (indeed this is the basic rationale for the development of the microfinance industry). Poor people therefore lack formal financial service alternatives to the MFIs. If MFIs are prohibited from offering savings services to poor people, those poor people are forced to resort to the informal sector in order to save.

It is clear, and now generally accepted, that poor people want, need and do indeed save. There is also increasing evidence that poor people are facing an extremely risky environment when they save in the informal sector. Thus it is clear that when discussing the risk to poor people's savings, this has to be evaluated on a relative basis. Very often all the alternative savings systems available to poor people are risky … thus poor people are left facing decisions on the ***relative risk*** (or relative security/safety) of the various semi- and informal savings systems open to them.

## Methods

***MicroSave*** used its existing extensive qualitative data set (comprising over 500 group interview [with groups averaging 6-8 people] and another 200 plus individual in-depth interviews) and complemented these with an additional 19 focus group discussions and participatory rapid appraisal exercises explicitly designed for this study. This qualitative work was complemented by a quantitative component. A private sector market research company, Research International was hired to carry out the quantitative component of the study, which was based on 1,500 face-to-face interviews among adults in Central, Eastern and Western Uganda.

## Results

The research revealed that 99% of clients saving in the informal sector report that they have lost some of their savings and on average they had lost 22% of the amount they had saved in the last year. 15% of those saving in the formal sector report that they had lost some savings and 26% reported that they had lost savings in the semi-formal sector. Thus the formal sector, for those lucky enough to have access to it, is safer both in terms of likelihood of losing any savings and in terms of the relative loss (amount lost to amount saved). Those with no option but to save in the informal sector are almost bound to lose some money – probably around one quarter of what they save there.

People who have access to the formal sector reported saving three times as much ($386) in the last 12 months than those who saved in the semi- and informal sectors. The people saving in the formal sector also reported a lower incidence (15%) of loss and a lower rate (3.5%) of loss in the last year.

## Discussion and Conclusions

*What It All Means for Central Bankers*

It is clear that commercial banks and the few larger MFIs that have transformed into a status that brings them under the supervision of Central Banks will never be able to reach out to offer savings services to poor people in remote rural areas. Indeed, with the increasing closure of rural commercial bank branches throughout Africa, the trend is the reverse. So some creative thinking and flexibility is required to address this issue. It is not good enough to say, "We cannot guarantee the security of your deposits at unsupervised institutions, so you cannot save with them" – this simply drives people into (or strands them in) the highly risky informal sector.

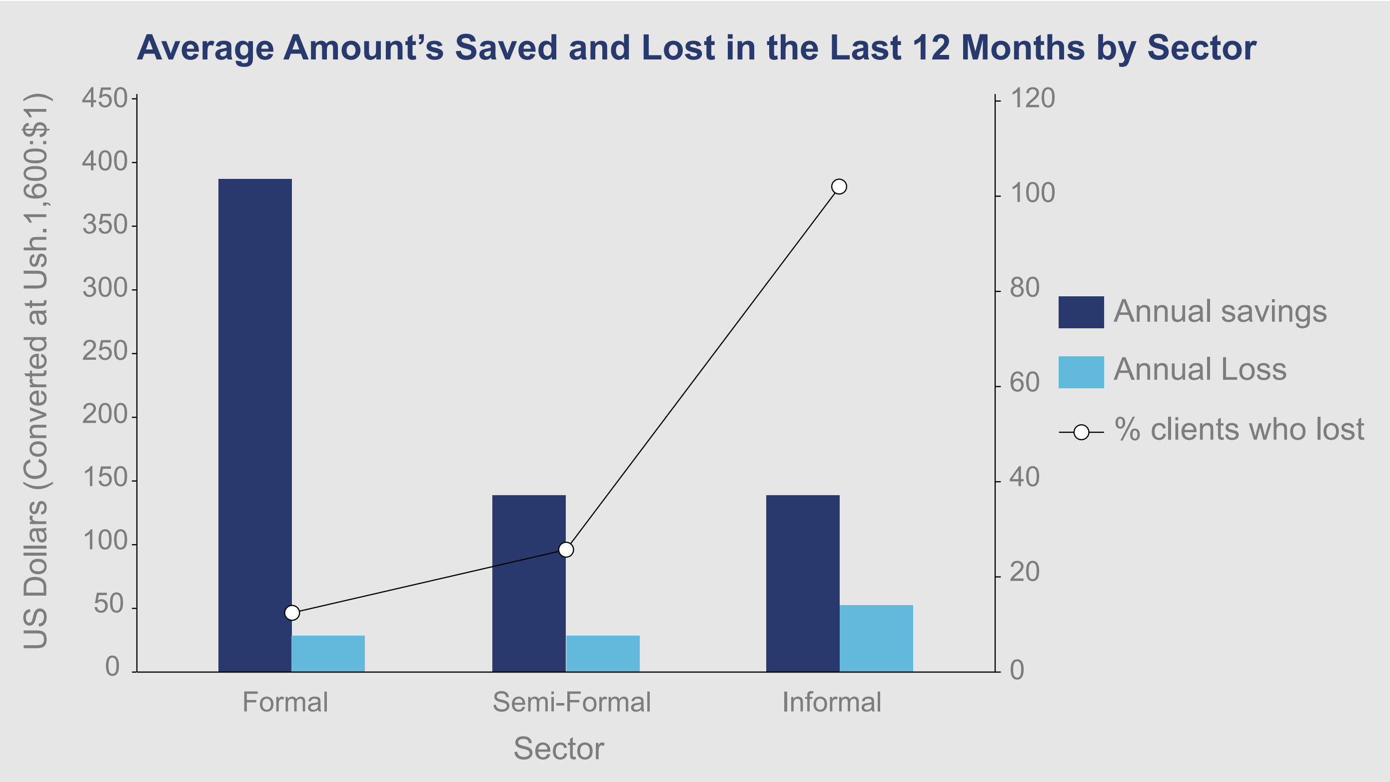
For too long Central Bankers have seen depositor protection in absolute terms: ***when considering "safeguarding the deposits of the poor", it is essential to think in terms of relative risk rather than absolute risk.*** In the same way that rich people make investment and savings decisions on the basis of the relative risk and return on the variety of opportunities available to them, so poor people are constantly faced with the need to assess the relative risk of the limited options they have to save.

*What It All Means for the Microfinance Industry:* Most would agree that smaller MFIs are risky institutions to which to entrust savings. However, as can be seen from the analysis above, on a relative basis, many are likely to be safer than the most common informal mechanisms the poor are forced to use by policies that prohibit MFIs from mobilising savings.

This is not to suggest that no efforts should be made to identify and close down semi-formal institutions that are deliberately seeking to defraud poor people of their savings. However, it is necessary to recognise that illconsidered, draconian prohibition of deposit mobilisation:

> *Neither* prevents such institutions starting up in areas where there are no (or limited) formal/semiformal alternatives for poor people – for example most of rural Africa, *nor* protects poor people's savings but instead leaves them in informal systems with a high relative risk.

In view of the highly risky nature of saving in the informal sector it is probably necessary to think more about helping clients understand the relative risk of saving in these semi-formal institutions. It should also be noted that the evidence from this study suggests that poor people do value some form of external accountability.




Clearly, this type of external accountability increases the trust of poor people in the institution and thus facilitates the institution's savings mobilisation activities. Thus serious semi-formal sector MFIs should want some form of external accountability.

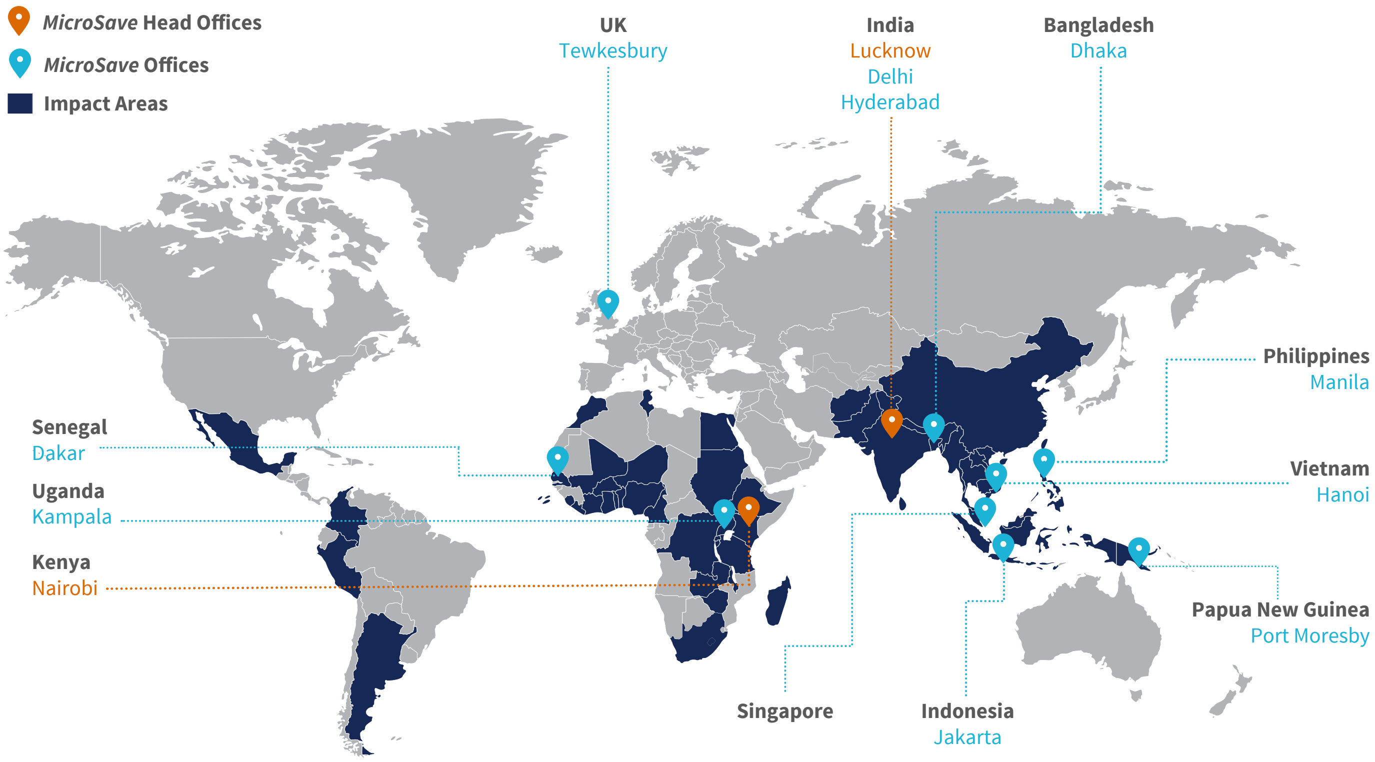
It is important to improve internal supervision (accounting systems, internal control, governance, adequate transparency to allow members to make their own decisions about the risk associated with saving in the institution etc.). At the same time the microfinance industry has to search for alternative and appropriate approaches to external supervision, probably a voluntary system based on decentralised, nongovernmental bodies.

That said, poor people cannot wait for the perfect system to protect their deposits ... indeed, the evidence from the formal commercial sector demonstrates that this panacea does not exist. In the short run, it is preferable to give poor people the choice rather than drive or strand them in the high risk saving environments with which they are currently faced. We must however, seek to inform that choice so that they can make their own decisions about the options available to them and the relative risk of each.

> *"Once again, it is time for the microfinance industry and the central bank to think "outside the box" and understand the issues from the perspectives of the end-user. Failure to do so could mean that wellintentioned regulations will trap poor people in the relatively high risk informal sector and prove once again that "it is expensive to be poor"."*
>
> ***Mutesasira and Wright, 2002***

## About *MicroSave*

*MicroSave* is an international financial inclusion consulting firm with nearly 20 years of experience, operating in eleven offices across Asia and Africa. Our mission is to strengthen the capacity of institutions to deliver market-led, scalable financial services for all. We guide policy, provide customised strategic advice and on the ground implementation support.

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