WOCCU World Council of Credit Unions, Inc.

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Striking the Balance in Microfinance

A Practical Guide to Mobilizing Savings

Lessons from Credit Unions in Latin America

Edited by Brian Branch and Janette Klaehn

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The editors dedicate this book to their parents
Betty and William
Ellen and Joe

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Foreword

Since the 1960s and up to the present, development finance players have focused on credit and borrowers. This focus is reflected not only in government policies, but also in the reporting requirements of donors, in the management information systems utilized by practitioners, and, finally, in the major microfinance innovations over the years. Government and donor policies continue to emphasize the role of *credit* in poor households and in micro- and small enterprises. Likewise, the major innovations and key contributions that have pushed the microfinance field forward have focused on credit programs (non-subsidized lending interest rates, full cost priced credit products tailored to specific niches, the operational and financial self-sufficiency continuum, and the use of borrower and loan officer incentives in loan product design and credit administration, to name a few). The vast majority of "microfinance" institutions (MFIs) continue to be *lending* institutions that offer individual, group, or solidarity loans. The "savings" services offered by most of these *microcredit* providers tend to be compulsory and non-withdrawable in nature, effectively increasing borrowing costs for clients and potentially creating disincentives for voluntary savings. While many MFIs have very effectively applied the numerous breakthroughs and principles of sustainable financial institution building to their credit programs, some of the same institutions have limited their innovations to credit. There is room to push the frontier further.

Over the decades, the World Council of Credit Unions, Inc. (WOCCU) has evolved its own technical assistance methodology dramatically from being credit-driven to being based upon savings-driven institutional self-sustainability. While WOCCU's work with credit unions has always included both lending and savings components, WOCCU's approach in earlier years had the net effect of borrower-domination and, in some cases, unhealthy reliance on external credit. By the early 1990s, WOCCU started experimenting with a more balanced approach that underscores the centrality of savings in self-sustainable financial institution development. Today, the role of savings in WOCCU's *Model Credit Union Building* methodology is to intermediate between the dynamic demand of net savers and net borrowers and eliminate reliance on external sources of capital. This demand-driven methodology of financial intermediation contrasts sharply with the supply-led approaches that dominate development programs in general. As a counter to the one-sidedness of supply-driven approaches, *Striking the Balance in Microfinance* shows in a step-by-step fashion how to mobilize savings to create more stable and robust MFIs and financial markets.

MFI competence in the mobilization of savings has three strategic virtues. First, properly implemented, savings mobilization contributes significantly to institutional self-sustainability. Savings can provide MFIs with a stable source of funds during periods of scarce availability of external funds. Secondly, access to voluntary, withdrawable, and safe savings facilities has a stabilizing influence on poor households as compared to the stressful effects of debt. Household savings plays an array of roles from increasing personal wealth, to smoothing consumption, and investing in human capital; indeed, household savings continue to be the most frequent source of start-up capital for microenterprises and self-employment. Thirdly, greater scale and better quality outreach to the poor results from combined savings and credit services, rather than from credit alone. For every poor person looking for a loan, there are four to eight poor people looking for a safe and accessible place to save.

Notwithstanding the clear merits of savings mobilization, not all MFIs should engage in savings mobilization for three reasons: (1) it puts people's money at risk, (2) it puts people's money at risk, and (3) it puts people's money at risk. Any MFI (including any credit union) that cannot assure the safety of the savings mobilized has no business raising savings from the public. MFIs (again, including credit unions) that lack the commitment and the capacity—technical or physical—to protect savings should refrain from savings mobilization. Given the reality that an MFI could be putting households' entire life savings at risk, it would be irresponsible and unethical to engage in savings services (or to encourage others to engage in savings mobilization) without the necessary safeguards and preconditions in place. Furthermore, the danger of undermining public confidence in the larger financial sector through lost or devalued savings simply cannot be overstated.

In other words, savings mobilization is serious business with serious responsibilities. There is a critical difference between MFIs that only provide credit services for the poor and MFIs that engage in both lending to and taking deposits from the poor. The difference is where the impact of mistakes is felt. If an MFI that only lends to the poor goes out of business, another institution loses the money that was lent to the now defunct MFI; no poor people lose their money. By contrast, if an MFI mobilizes savings from the poor and then goes out of business, poor savers lose their money—potentially their life savings.

Written by practitioners for practitioners, *Striking the Balance in Microfinance* will benefit the full array of microfinance players—MFIs, technical assistance providers, donors, and policy makers. Any institution that is serious about the mobilization and protection of client savings should read and use this book.

Lucy Ito
Vice President
WOCCU

Madison, Wisconsin
October 29, 2002

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Chapter 1 The Keys to Striking the Balance: An Introduction to Savings Mobilization

Brian Branch and Janette Klaehn

Voluntary savings are fundamental to sustainable economic development. They are the most frequent source of funding for microenterprise startup and expansion. Voluntary savings enable households to smooth consumption in the face of uneven income flows, to accumulate assets for the future, to invest in education, and to better prepare for emergencies. Despite the importance of savings, the large majority of microsavers continue to lack access to safe and sound institutions where they can deposit their savings.

What most distinguishes credit unions from other non-bank financial entities offering microfinance services is their ability to mobilize large numbers of small, voluntary savings accounts. Credit union savings mobilization programs throughout Latin America have demonstrated that low-income and poor people will substantially increase their savings in financial form if they are provided with safe and convenient places to deposit their funds. The World Council of Credit Unions, Inc. (WOCCU) has implemented credit union strengthening and savings mobilization programs in Bolivia, Ecuador, El Salvador, Guatemala, Honduras, Mexico, and Nicaragua. WOCCU experience demonstrates that credit unions that combine sound financial disciplines, saver-friendly product offerings, and aggressive outreach can satisfy member demands for savings services and rapidly generate high levels of liquidity. The liquidity from savings deposits supplies credit unions with the funds to meet local member credit demand and provides the institutions with a stable and long-term source of self-sustaining financing. In other words, the credit unions evolve into true financial intermediaries, raising savings deposits to fund their lending portfolios.

Table 1.1 shows the dramatic growth from 1999 to 2001 in voluntary savings volume and in the number of members and clients served by credit unions affiliated with WOCCU credit union strengthening programs in Latin America.

Table 1.1 Voluntary Savings in WOCCU Latin America Programs

Country	# of CUs	1999 Total Deposits[1]	2001 Total Deposits[1]	Percent Growth in Deposits	1999 # of Members[2]	2001 # of Members[2]	Percent Growth in Members[2]
Bolivia	15	$22.0	$32.7	48.6	45,436	60,179	32.4
Ecuador	20	$31.5	$105.3	234.3	759,741	879,596	15.8
Guatemala	28	$76.2	$132.5	73.8	305,848	406,074	32.8
Honduras	21	$28.0	$34.3	22.5	149,304	194,034	30.0
Nicaragua	17	$0.7	$1.6	157.1	11,937	17,397	58.3
Total for 5 Programs	**101**	**$158.4**	**$306.6**	**93.5**	**1,271,658**	**1,557,820**	**22.5**

[1] *Deposit amounts are rounded to nearest whole in millions of U.S. dollars as of December 1999 and 2001.*
[2] *Includes both members who own shares and non-member clients who do not own shares, but do use savings services.*

The fact that total deposits grew four times as fast as the number of members and clients suggests that the credit unions have been successful both in attracting new members and clients who are net savers and in convincing existing members and clients to increase their deposits. The dramatic increase in total deposits demonstrates that the institutions have been successful in building the trust of new and existing savers.

Trust is a common theme throughout this book. In chapter 2, Cifuentes reminds readers that savers take all of the risk in this relationship. He also discusses how an institution can establish the financial disciplines necessary to build a sound institution where savers will be able to entrust their deposits. In chapter 3, Branch details the key features savers seek, noting that the first priority is safety and security (which inspire client trust). Branch also discusses policies and procedures so that savers will be able to trust that their deposits are well managed. In Chapter 4, Linares builds on these discussions and reminds readers of how essential trust is in the marketing of savings. Linares suggests to

Organization of *Striking the Balance in Microfinance.* **This book examines the process of mobilizing savings. The first five chapters provide policy, product, and guideline materials. The next three chapters present case studies from credit union savings mobilization programs in Latin America. The toolkit provides worksheets, surveys, and sample forms for readers to use in their own savings mobilization efforts.**

readers how they can build trusting relationships with their clients. The authors of the case studies emphasize that trust was fundamental in the experiences of the Nicaraguan and Ecuadorian credit unons. Trust is the foundation of savings mobilization.

Objective

The purpose of this book is to capture and share the best practices and lessons learned from credit union savings mobilization programs in Latin America. The authors present the methodologies and tools that they, together with their colleagues in the region, employ to mobilize savings in credit unions. The authors provide policy, product, and guideline materials for credit unions and other microfinance institutions (MFIs) that plan to initiate, update, or expand their savings services. The term *savings institution* is used throughout the book to refer to those institutions that (1) are legally authorized to accept deposits from their members or from the public, and (2) whose primary source of funds is voluntary savings deposits.

The book takes readers through the process of mobilizing savings—from assessing the readiness of their own institutions to raise deposits responsibly, through instituting financial disciplines, establishing policies and procedures, developing products, devising marketing strategies, and determining the costs. Case studies demonstrate how credit unions in Nicaragua and Ecuador implemented successful savings programs to grow their institutions and better serve their members and clients, even during times of crisis. The toolkit provides worksheets, surveys, and sample forms for readers to use in their own savings mobilization efforts. Together, the methodologies and tools provide practitioners with a comprehensive, practical guide for mobilizing savings in their own institutions. The lessons should also provide donors and other development organizations with models for designing successful savings mobilization programs in credit unions and other types of MFIs.

Voluntary Savings

What are voluntary savings? Voluntary savings are savings, not for access to credit, but for *the sake of saving*. Voluntary savings are characterized by convenience and return: the ability to deposit and withdraw at will and earn market-driven rates of return on funds deposited. The authors focus on voluntary, withdrawable savings.

Savings mobilization refers to creating safe and sound institutions where savers can place their deposits with the expectation that they will receive the full value of their funds, plus a real return, upon withdrawal. It means developing appropriate products to satisfy the local demand for voluntary savings services and marketing those products to savers of varying income levels. Simply put, savings mobilization is capturing voluntary savings deposits, protecting them, managing them, and using them to fund loan portfolios.

To make clear the distinction, forced savings are those contributions to a savings account required to gain access to loans. Many

What is WOCCU? The World Council of Credit Unions, Inc. (WOCCU), a member-based development and trade association, provides advocacy, a platform for innovation and knowledge exchange, and technical development assistance to its members, credit union organizations, and related user-owned financial institutions worldwide. By implementing short- and long-term credit union strengthening programs, WOCCU extends the frontier of credit union outreach and sustainability—expanding the breadth and depth of credit union services so that more and poorer people have increased access to affordable financial services. Savings mobilization is integral to the WOCCU technical assistance program. WOCCU also works to create appropriate regulatory environments for safe and sound credit union operations. WOCCU has credit union affiliates in Africa, Asia, the Caribbean, Europe, Latin America, North America, and the South Pacific. At year-end 2001, WOCCU represented more than 112 million credit union members with a combined total savings of $530 billion.

traditional credit union and non-governmental organization (NGO) practices require members or clients to accumulate savings or shares which are illiquid and from which they can leverage loans at two to five times what they had accumulated in forced savings or shares. Others require that as members or clients repay loans, a portion of the payment go into a savings or share account.

Compulsory savings are driven by the idea that institutions will (1) "teach" members or clients how to save and (2) ensure availability of funds for lending. Members and clients already know how to save; they need institutions that can provide them with the instruments to enable them to do so in financial form. In credit unions, compulsory savings do not in fact provide sufficient volume to fund loan portfolios. Credit unions must expand their outreach and offer voluntary products that are attractive to members and clients of varying income levels to generate the level of funds required to finance their loan portfolios entirely with savings.

WOCCU has consistently found voluntary savings instruments to be more popular than forced savings products among credit union members and clients in Latin America. Voluntary savings have grown much faster than forced savings in credit unions engaged in savings mobilization programs because of the ease of access and the higher interest rates paid on them. In other words, where credit unions offer appropriate products, members make use of the voluntary savings to save in financial form more often than they save for the purpose of accessing loans.

Lessons From the Credit Union Experience

Credit unions, or savings and credit cooperatives, are member-owned financial institutions that offer savings and credit services to their members in developing, transitioning, and developed countries. Credit unions serve members of all socioeconomic levels with an array of financial service products. Whether in developing, transitioning, or developed countries, the purpose of a credit union remains the same: to provide members with financial services to improve their economic and social well being through asset accumulation and income generation. Voluntary savings mobilization is a critical tool to this end, equally or more important than the provision of credit services.

Credit union members purchase a share or shares in the institution when they join. With the purchase of shares, members gain access to the services provided by the credit union and obtain one vote to exercise at the annual general meeting and when votes are called. The boards of directors are generally made up of elected members.

Depending on a country's legal framework, credit unions may be authorized to mobilize member savings by the Superintendency of Banks, the Central Bank, the Ministry of Finance, the Ministry of Cooperatives, or by a freestanding law. In numerous countries, credit unions are legally authorized to serve non-members with deposit services; therefore, although only members are eligible to vote and borrow, members and clients both can access the savings services. Ideally, the government authority that is responsible for supervision of the formal financial sector supervises credit unions.

Why Do Credit Unions Focus on Mobilizing Savings?

Credit unions around the world provide savings services to their members and clients on a sustainable basis. By providing services to members and clients of diverse income groups, credit unions have tapped into savings deposits as a relatively stable, low-cost source of funds to finance growing loan portfolios. These funds are loaned to members to fund productive investments in agriculture, education, housing, and microenterprise in the local community.

Credit unions have long claimed that savings deposits provide them with a cheaper source of funds. The market cost of paying individual depositors tends to be lower than the non-subsidized inter-lending rate for loans in financial markets. In chapter 5, Richardson and Oliva test the validity of these claims through an empirical analysis of credit union savings costs in four countries—Bolivia, Ecuador, Guatemala, and Nicaragua. They find that compared to the borrowing costs in the local capital markets, the costs of providing real market-based returns on savings tended to be lower for the institutions. While the costs of savings deposits are not likely to be less than those of subsidized credit lines, Richardson and Oliva argue that the tailored and unique reporting requirements of donor-funded sources of funds do raise the administrative costs of those funds when compared to locally-mobilized savings.

The existence of savings deposits as an independent source of funds reduces the dependence of credit unions and other savings institutions on the boom and bust cycles of external credit sources. Mobilizing savings also reduces the risks associated with external credit programs that may be subject to political or targeted motives. Therefore, credit unions hold to the principle that internally-generated savings provide an independent and sustainable supply of funds that can be invested in the local community.

Beyond serving as a source of funds, credit unions have found that savings mobilization serves as a primary ingredient of good governance. Drawing on an earlier work by Branch and Baker about overcoming credit union governance problems, Cifuentes reminds readers that it is the simultaneous presence of savers, who provide the funds, and borrowers, who borrow the funds, which forms the basis for a self-sufficient and balanced financial intermediary. Net savers demand high deposit rates and strong prudential disciplines to protect their savings, while net borrowers tend to demand low loan rates and easy access to credit. The conflicting objectives require the board of directors and managers in the institution to find a balance that serves both savers and borrowers.

The quality of the savings services and the loan screening and collection practices will determine the proportion of savers to borrowers in an institution. In member-owned institutions, this relation of savers to borrowers is reflected in the nature of the directorship: borrower-dominated or saver-borrower balanced. Borrower-dominated credit unions tend to put savings at risk, discourage net savers, and attract those looking for cheap loans, effectively keeping those institutions borrower-dominated. Credit unions with high-quality savings services attract net savers as well as net borrowers. The net-savers exert pressure upon the board and management to adhere to prudential disciplines, keeping the institution relatively balanced.

This balance in governance is determined in part by the mix of savings and loans offerings. It is constrained and guided by the rules and bylaws which Cifuentes discusses: operational responsibility and flexibility for management, establishment of prudential standards, accountability of managers for financial performance, oversight responsibilities of directors, and controls over conflicts of interest. While these rules may be specific to credit unions, similar principles are necessary for the sound governance of any savings institution.

Savings mobilization influences the financial management of an institution. The threat of deposit withdrawal due to savers' lack of confidence in management should compel managers to operate within prudential guidelines, since widespread withdrawals would eliminate the base of funds and threaten the sustainability of the institution. As a result, directors and managers are forced to operate according to sound principles, including adequate capital reserves, loan loss provisions, and liquidity reserves in order to protect client savings and the existence of the institution.

Increasing Outreach and Serving More Clients

Credit unions are mixed outreach institutions. This means that in order to generate the volume of liquidity needed to meet the loan demands of the many low-income members and to offset the costs of providing microsavings services, credit unions also raise savings from higher-income segments with more stable income flows and larger savings accounts. From their different perspectives, all of the authors in this book point out that mixed outreach enables savings institutions to reach more low-income and poor members than they would if they restricted services to this segment alone. As Branch and Linares both note, savings institutions should develop savings products to target different income groups so that they are able to attract the volume of savings needed to sustain independent financial intermediation. As Richardson and Oliva point out in their discussion of costing, institutions must broaden their outreach to attract more clients if they are to provide savings services in a cost-effective and sustainable manner.

Financial intermediation requires that institutions attract both net savers and net borrowers as clients. Credit unions have found that serving large numbers of small savers generates a significant volume of funds; however, self-sustainability depends on attracting large numbers of these small savings accounts together with a smaller number of large savings accounts. WOCCU surveys in Bolivia, Ecuador, and Guatemala reveal that credit unions often average four to eight savers for each single borrower. The higher the number of net savers per borrower, the better the liquidity condition of the institution. The chapters by Branch and by Richardson and Oliva illustrate that it is the combination of many small accounts, a moderate number of mid-sized accounts, and a few large accounts that together provide the volume of savings required (1) to fund the loan portfolio, and (2) to offset the costs of providing microsavings services.

The pattern demonstrated in the 15 Bolivian credit unions shown in Table 1.2 is repeated in credit unions throughout Latin America that have successful savings mobilization programs: many small accounts serving low-income members (94.1 percent of passbook savings accounts have balances less than $500 and provide only 29.3 percent of the funds) and fewer large accounts serving higher income members and providing the large volume of funds (6 percent of accounts with balances greater than $501 provide 70.8 percent of the funds).

Table 1.2 Passbook Savings Accounts in 15 Bolivian Credit Unions[1]

Account Size in U.S. $	Number of Accounts	% of Number	Volume of Accounts[2]	% of Volume
0 – 100	64,048	53.4	1.0	5.5
101 – 500	48,895	40.7	4.3	23.8
501 – 1000	3,796	3.2	3.2	17.5
1001 +	3,306	2.8	9.6	53.3
Total	120,045	100.1	18.0	100.1

[1] *As of December 31, 2001.*
[2] *In millions of U.S. dollars, rounded.*

Environmental Requirements for Mobilizing Savings

As Cifuentes points out, three key environmental elements repeatedly stand out as critical for mobilizing savings: limited inflation, legal authority, and supervision.

The ability of any savings institution to successfully mobilize savings is contingent first upon a macroeconomic environment which allows the institution to operate at rates that are viable and sustainable while providing a real positive return to protect the value of client savings. When inflation rates are high—12 to 60 percent—savings institutions can use several strategies, including variable rates, hard currency value-pegging, and short-term lending, to protect the real value of savings. Inflation rates between 60 and 120 percent require very limited short-term operations. When inflation rates exceed 120 or 150 percent, financial intermediation breaks down. The ability of a savings institution to manage savings will depend on the level of inflation and that institution's ability to manage its pricing and costs in order to maintain real values. Branch discusses interest rates and product pricing. The costing model presented by Richardson and Oliva should enable readers to get a clear picture of what it costs their institutions to mobilize savings.

If savers are unable to recover the real value of their savings, they have been provided with a disservice. Where returns are negative, dis-intermediation occurs as the value of savings decreases. In high-inflation economies where political instability and shallow financial markets allow for few alternatives, savers may have to accept a return that is less than the real value of their savings as the cost of saving. If inflation rates continue to exceed the return on financial savings, many people will choose to invest their savings in alternative forms or assets—real goods, such as animals or building materials—which may be illiquid but will maintain their value. The problem with saving in alternative forms arises when a saver needs to access his or her savings quickly, but may not be able to liquidate the asset.

Savings mobilization is a contract between parties: the institution receiving the savings and the individual placing savings in that institution. For that reason, savings services need to operate within an established legal framework that identifies which institutions, under which criteria are able to receive savings from members or from the public. The legal framework should also identify what recourse savers have to recover their savings from institutions in times of crisis. As Cifuentes and Branch each point out, when savers place their savings in an institution, they assume the risk. Savers are entitled to at least a minimum contractual protection, provided by an established legal framework that clearly defines their property and claim rights.

Savings institutions are able to mobilize savings responsibly and more effectively within the safety of adequate regulatory and supervisory frameworks. Institutions that mobilize voluntary deposits should be supervised by the government regulatory agency responsible for supervision of the financial sector. Effective supervision requires a sound legal system, formalized audit requirements, supervisory monitoring capacity, an established regulatory framework, and authority to enforce the law.

Significant differences in the quality of management and savings protection are found when comparing credit unions supervised by the formal financial sector regulator with those not supervised by the regulator. The credit unions supervised by the regulator tend to institute stronger financial disciplines. At the same time, many credit unions do operate in markets where they are poorly supervised by cooperative agencies or non-financial ministries. In these situations, the savings institution is responsible for adhering to the financial disciplines necessary to manage savings safely, monitoring its own financial performance, and advocating for greater commitment to and capacity for supervision on the part of the government regulator.

Institutional Preconditions for Mobilizing Savings

Electing to mobilize savings from clients is a strategic, long-term decision. Savings mobilization is not only a matter of offering a few savings products to expand the product portfolio, but rather it requires a fundamental reorientation of the institution. Cifuentes sets out seven preconditions that an institution must meet *before* mobilizing savings. He then describes the critical elements that managers in a savings institution should implement *throughout* the process of savings mobilization. Cifuentes outlines the steps that readers can take (1) to assess whether or not their own institutions are ready to mobilize savings responsibly, and (2) to prepare their institutions to mobilize savings.

Cifuentes explains that savers must be able to trust that the savings institution will safeguard their deposits. Savings institutions must be able to assure the capacity to return the full value of savers' deposits when they need them. Cifuentes describes the business culture—market orientation, effective governance, transparent accounting, sound financial management, performance monitoring, professional capacity, convenience of service, safe and sound image, and business planning—established among Nicaraguan credit unions that undertook a rigorous institutional strengthening program that included savings mobilization as a fundamental pillar.

Before engaging in or accelerating public savings mobilization, a savings institution must establish prudential financial management disciplines as standard, well-understood practice. This establishment of disciplines means more than merely meeting basic requirements of solvency. Savings institutions must establish the core disciplines of delinquency control, loan loss provisions, liquidity reserves, control of non-earning assets, profitability, and capital reserving in order to protect client savings. Cifuentes points out that financial disciplines are interdependent and mutually reinforcing; as such, they should be implemented as an integrated system, not in a piecemeal manner that addresses some risks but not others. A transparent accounting system with clearly defined nomenclature is necessary for an institution to be able to monitor that the disciplines are in effect.

Liquidity management and liquidity reserving are essential to savings mobilization. While an institution can control the number of borrowers it serves, it cannot limit the number of savers that come to deposit and withdraw savings. Once savings services are offered, an institution cannot turn savers away because that would cause a crisis of confidence in the institution. Before offering saving services, managers in an institution must make sure that the institution has the expertise to manage liquidity to meet withdrawal and disbursement demands and the capacity to serve the increased number of clients.

When an institution mobilizes savings, liquidity increases and those funds are redirected as loans into the community. It is critical that the savings institution has in place strong policies, methodologies, and practices for credit screening and risk analysis so that the loans financed by savings are collectible. Risk management must include strict delinquency monitoring, reserve provisioning, and collections, as well as effective risk analysis and credit screening.

A savings institution builds lines of defense to protect client savings. Loan loss provisions provide the first line of defense. Risk of loss is observable directly in the delinquency of the loan portfolio. If nonperforming loans are not recovered, then the savings that funded those loans are lost. The institution creates provisions from income in the amount that will be required to replace the savings, as a percentage of loans delinquent and depending on the age of the delinquency. Beyond loan delinquency, there are risks that are not observable: risks that may be due to unexpected losses or systemic shocks. The institution builds reserves retained from earnings or "institutional capital" as a second line of defense. These resources are owned by the institution and set aside to absorb losses before they can impair the value of savings. Credit unions create a third line of defense with the shares that members invest as risk equity in the institution. If provisions and reserves are not sufficient to absorb losses, then shares absorb the losses before impairing deposits.

Cifuentes provides an overview of the PEARLS financial performance monitoring system, developed by WOCCU to provide management guidance for credit unions and other savings institutions. PEARLS is also a supervisory tool for boards of directors and regulators to use in monitoring financial management. PEARLS can be used to compare and rank institutions; it can provide comparisons among peer institutions in one country or across countries. The PEARLS system uses a set of financial ratios to measure key areas of credit union operations: Protection, Effective financial structure, Asset quality, Rates of return and costs, Liquidity, and Signs of growth. The PEARLS system provides performance standards for the key disciplines of prudent financial management.

Whereas some PEARLS indicators are specific to credit unions, many are relevant for other MFIs as well. Monitoring systems that are specific to other types of MFIs also exist; for example, the ACCION CAMEL framework analyzes and rates quantitative and qualitative indicators specific to NGO-based MFIs. The key indicators of CAMEL are: Capital adequacy, Asset quality, Management, Earnings, and Liquidity management. As Cifuentes notes, whether a savings institution elects to use PEARLS or another monitoring system, it is imperative that the institution establishes and adheres to a system that enables managers, directors, and supervisors to track financial performance.

Savings growth is highly correlated with the perceived soundness and professionalism of the institution mobilizing savings. Cifuentes and Miranda, later in Chapter 6, illustrate the importance of physical image by providing examples of Nicaraguan credit unions that re-launched their community images as part of their efforts to inspire public confidence and mobilize savings. The professional, secure, and attractive public image of the physical infrastructure of the institution does much to create an image of soundness and professionalism. Branch and Linares build on the importance of institutional image in their discussions of savings management and marketing.

Cifuentes introduces the concept of minimum "professional capacity." He asserts that to receive and administer savings in an efficient manner which does not impair their value requires a minimum of professional capacity; that is, a professional staff with training in how to manage savings. Cifuentes notes that managers must be qualified to manage financial intermediation. He states that one cannot assume that staff experienced in providing credit will be able to transition to providing savings services. Different issues in client service, cash management, and marketing require that employees receive targeted training in providing savings services. Linares furthers this point when he argues that marketing efforts are wasted if staff members are not properly trained. He offers suggestions for low-cost distance training.

Readers will note that professional capacity is addressed in all of the chapters. The authors refer to *managers* making proactive decisions; for instance, whether or not to institute financial disciplines, establish policies and procedures, manage savings, devise a marketing strategy, or analyze costs. Savings mobilization may require managers to make decisions that are challenging for the institution or difficult for the staff. When managers are tasked with protecting client savings, they assume a greater responsibility that is likely to require capacity-building efforts across the organization.

Savings Products

As the critical elements for responsible savings mobilization are put in place, institutions define their product offerings and implement policies and procedures to manage those products. Branch presents savings mobilization as a demand-driven activity aimed at clients who save for the purpose of saving. He states that a savings institution must first convince savers that their savings will be safe and well managed. Then the institution designs and offers savings products that will satisfy the service demands of clients in the local market. Branch focuses on establishing the framework for savings mobilization through his analysis of key components of the process: products, pricing, account procedures, and savings management.

Branch bases his discussion on the premise that savers look for institutions that can provide them with safety, convenience, and return, in that order of priority. He discusses the tradeoff between liquidity (access) and return (compensation) and suggests that institutions must offer a range of products to satisfy the varying demands of savers. A continuum of savings products can be developed, ranging from passbook accounts, which offer complete liquidity and lower returns, to long-term accounts with restricted liquidity and high returns. Low-income and small savers have exhibited a willingness to sacrifice returns in exchange for complete access to their funds, whereas larger and wealthier savers generally prefer to sacrifice liquidity in exchange for higher returns on their savings.

Savings products are also built by tailoring them to respond to the demands of particular market niches (farmers, transportation agents, or vendors, for example), or to purposes for which clients save (education fees, large purchases, or housing). Product design must be simple and clear to be attractive to savers and to keep administrative costs low.

Branch sets out the defining characteristics of products. The core characteristics include: target market, interest rate, minimum opening deposit, minimum balance requirement, withdrawal policy, promotion, and institutional implications. The credit union experience in mobilizing voluntary savings has focused primarily on six savings products: passbook accounts, fixed-term certificates of deposit, youth savings, programmed savings, institutional accounts, and retirement accounts. The most popular savings product is the passbook account, followed by fixed-term certificates of deposit, then programmed accounts (such as Christmas, housing, or school fee programs).

Branch outlines the procedures for opening accounts, making deposits and withdrawals, and closing accounts. He emphasizes that procedures must be clear, simple, and standardized so that clients and staff fully understand how the systems work. Established procedures decrease transaction costs for both clients and the institution, and they minimize errors.

Setting Interest Rates

Interest rates determine the returns savers earn on their deposits and the price that institutions pay for the use of the funds. According to Branch, interest rates should be competitive with market rates, cost-based, and positive in real terms above inflation. He asserts that managers should have the authority to increase or decrease the rates offered on savings to respond to market trends and remain competitive.

The administrative and transaction costs amount to a higher percentage of the value of smaller accounts than of the value of larger accounts. Consequently, savings institutions offer higher interest rates on accounts with higher balances and lower interest rates on accounts with lower balances. Savings products should be designed to increase rates with higher account balances to encourage savers to increase their deposits. For fixed-term products, interest rates increase with the term to compensate clients for sacrificing liquidity for longer periods.

Pricing varies across savings products because the institution's costs vary according to the different transaction costs, account balances, terms, withdrawal frequencies, and services associated with each product. For those products with frequent transactions and more administrative steps required for account management, lower interest rates are paid to compensate the institution.

Savings Management

Effective savings management requires consideration of liquidity reserves, cash-handling procedures, and internal controls for managing non-financial risks. Again, the issue of trust comes up, as Branch reminds readers that savings mobilization requires public confidence that clients will be able to access their savings when they want them.

Liquidity management requires a reserve to be created as a percentage calculated on all withdrawable savings. The savings institution deposits these reserves in short-term, secure investments in formal financial institutions. This reserve ensures that the savings institution will have funds available to meet withdrawal and disbursement demands. The Bolivian deposit structure that was illustrated in Table 1.2 reflects the same structure found by Branch and by Richardson and Oliva in their structural analyses: many small accounts and then a few large accounts that provide the large volume of funds for loans. Compared to large accounts, the many small accounts tend to be stable as long as savers have confidence in the safety and soundness of the institution. On the other hand, the larger accounts tend to be more rate-sensitive and may move rapidly with changes in market interest rate levels. Most liquidity risk stems not from the many small, liquid accounts, but from the fewer large accounts. An unexpected withdrawal of one or more of these accounts can leave the savings institution with insufficient liquidity. A higher liquidity reserve rate for larger accounts compensates for the higher risk of the concentrated deposits in the large accounts.

For institutions that have not offered savings services or which have only received savings via payroll deduction, the decision to accept over-the-counter cash deposits introduces a new series of risks. Cash management procedures must be introduced, including daily procedures for the retrieval of teller cash from the vault, logging a teller balancing report or operator journal to record cash inflows and outflows, filling out vault tickets to purchase additional cash, and putting cash away in teller drawers. Risk management requires internal controls that include security measures and established rules for common transactions. Staff training is another element of managing risk.

Savings Product Development

Like the other authors, Linares notes that trustworthiness and client confidence are critical to the continuing existence of a savings institution. When several financial institutions in the local market can project images of safety and soundness—creating strong brands—clients will make their choices based on the services and products offered. They will place their deposits in the institution that best meets their saving needs. Financial institutions with a solid brand (reputation) must distinguish their models (services) and options (products) to differentiate themselves from competitors.

Linares provides instruction on how to evaluate the position of existing products in the market. He discusses a four-phase product life cycle (Launch, Growth, Maturity, Decay) that can be used to describe the evolution of products and evaluate their robustness. During the *Launch* stage, the product is developed and presented to the market. In the *Growth* stage, product sales start to grow and gain market share—attracting new market segments. During the *Maturity* stage, the product market share reaches its limit as new market niches are saturated. And finally, in the *Decay* stage, the product loses market share and becomes obsolete, serving only long-term clients and requiring that the savings institution re-package, add options, or discontinue the product.

The first step in determining if a savings institution meets client demand is to evaluate existing products and to determine in which stage of its life cycle each product falls. Various sources of information can be used to evaluate products, including client complaints, staff observations, market research, competitor activities, and national financial market behavior. The next step is to choose the appropriate marketing strategies to apply to existing products based on their respective stages in the life cycle.

Developing New Savings Products

When existing products do not meet local demand, new products must be developed to fill the void. Linares cautions that because designing and launching new products can be costly, new products should be developed only where managers have determined through careful study and market research that existing products cannot be adapted to meet the demand.

Linares reminds readers that financial markets in general, and specifically the microfinance market, are not made up of uniform collections of people who will be satisfied with cookie-cutter financial services. Rather, the market is a collection of groups and niches with varying demands and preferences. Linares has found that first-time savers are usually motivated to start saving money by a need for security and a desire to avoid the risks inherent in saving in cash or alternative forms. Like Branch, he finds that these savers generally seek liquid products with low minimum balances. First-time savers will remain loyal to the savings institution for as long as the institution remains secure and provides convenient services.

This pattern is consistent with the observations by Branch that the many small accounts of low-income passbook savers provide a stable source of funds. Experienced savers, on the other hand, may have established accounts with significant balances in other savings institutions. Their principal concerns are also security and convenience, but individuals in this group will also consider rates of return when choosing savings products. These experienced savers are willing to sacrifice liquidity to maximize returns; they are loyal only as long as the return paid by the savings institution is the highest in the local market. This type of information about clients is essential for designing targeted products. Linares touches on how savings institutions can use client relationship management software and databases to capture this kind of information and use it to develop successful products and improve client services.

After defining the market, the next step in the product development process is to research the market to determine whether there is sufficient demand to pilot test a savings product. A product concept is designed and tested, internally and then externally. It is first pilot tested with a group of clients in a controlled market, such as in one of the financial institution's branch offices. Follow-up market research with this group identifies and fixes any design flaws. Then, the new product is launched onto the market. The launch requires aggressive marketing so that the new product gains momentum to grow in the local market. Linares also suggests that when a new product is developed, it should be related to existing products so that products and services may be bundled or packaged when offered to clients.

Marketing Savings

Savings mobilization depends on marketing. Savers can only deposit their funds if they are aware of the services available to them. Savings institutions use a combination of sales, cross-selling, media advertising, point-of-sale advertising, direct marketing, and promotions to attract savers. The primary objectives of marketing activities in a savings institution are:

- To identify and attract the net savers in the local market;
- To improve the competitiveness of services; and
- To build up the public image of the institution.

A key indicator of a successful marketing strategy is the ability of the savings institution to attract a broad mix of both savers and borrowers on a scale sufficient to generate the earnings necessary to sustain services and institutional growth. Successful savings institutions designate at least one staff member to be directly responsible for marketing activities.

The marketing effort may involve market research or feasibility studies to examine demographic and economic characteristics of the local market. As Linares points out, quantitative research provides data from secondary information sources such as census and databases. Qualitative data is gathered from primary sources, such as focus groups and client surveys. Linares provides an overview of commonly-used quantitative and qualitative market research tools.

Branch and Linares each highlight the importance of market studies. Savings institutions conduct market studies to analyze the services provided by other financial institutions in the local market. These studies profile the clients' use of financial services and compare the competitive characteristics of services: prices, terms, minimum balances, convenience, waiting periods, service variety, and sophistication of products. The studies also compare interest rates on similar products among institutions. This information can guide managers in defining strategies for new product development, service improvement, and marketing activities.

Cifuentes states that an institution should have a defined marketing plan in place, since marketing is a critical element in launching a savings mobilization program. Linares builds on this idea and discusses the essential points of an effective marketing plan: specific objectives, goals, activities, and indicators for evaluation of impact. A marketing plan also establishes a budget for the marketing activities. In all cases, the marketing plan must be compatible with the annual business plan of the institution.

Reaching Out to Savers

Because of the nature of cash deposits, there are no real substitutes for over-the-counter transactions. Linares highlights how savings institutions can open branches to expand their outreach to new clients and new communities. He offers information on five different levels of branches. Depending on the legal framework in the country, the demand for savings services, and the developmental stage of the institution, branching can be as simple as setting up a window in a local market or as complex as establishing a full-service regional office to which other branches report.

Strategies to Penetrate the Market

Linares reviews promotional strategies based on image, quality of service, and rates of return. He contends that strategies based on image, or brand, are the least expensive and most efficient ways to mobilize increased savings. A common theme throughout the book, Linares notes that to compete in the savings market, an institution must project an image of professionalism, safety, and security. These are the elements around which an image, or brand, is built.

The branded image is reinforced with appealing names, attractive logos, standardized printed materials, and uniforms. An attractive physical infrastructure strengthens the perception of the brand. Savings institutions need physical facilities that project an image of security: secure doors, grills for windows and air conditioners, strong boxes, vaults, and security systems. Well-lit, bright, and clean teller areas and lobbies are reassuring to savers.

Uniformity of presence reinforces the image of professionalism. Branch offices should carry the same name, signage, and building façade as the main office. Colors and interior design elements should also be standardized. This uniform presence sends a clear message to clients that they can expect consistent quality of service from all points of service.

Branch points out that branding can be applied to products as well as institutional images. Savings institutions give appealing and memorable names to savings products in order to associate them with a high-quality image. Names may be assigned based on account size—platinum, gold, or silver—or according to purpose—home improvement savings or school fee accounts. Consistency of the product image and branding is carried through on brochures, lobby signs, posters, and paper forms and applications. Later, Richardson and Oliva point out that institutions must be sure to use appropriate marketing strategies for each market niche in their efforts to manage the costs related to savings mobilization.

Linares notes that, although marketing through mass advertising can be expensive, it can also be cost-effective in reaching large numbers of low-income savers. Brochures and other direct marketing materials are important marketing tools, but they do not constitute a marketing strategy by themselves. The marketing tools that Linares sets out early in his chapter are used in combination as components in a larger marketing strategy.

Like other authors, Linares recognizes that security and convenience are the primary reasons for which savers select a savings institution. In most cases, interest rates are secondary to that selection. He concludes that savings institutions should try to attract savers by providing high-quality service and offering rates that are competitive in the market, and not by offering rates that are higher than market rates.

Linares clarifies that fixed-term deposits require a different marketing approach than passbook accounts. Users of fixed-term products are looking for the best interest rate for a given term. He notes that such clients may move their money to another savings institution for a very small difference on the rate of return. As a result, interest rates are more important in marketing strategies for fixed-term deposits than for passbook savings.

Quality of Service

Linares emphasizes that the best promotional strategy for savings mobilization is to create an association between the products and the perception of high-quality client service. He describes three components of high-quality service: speed, response, and convenience. The client wants to spend as little time as possible transacting business. Clients want access to financial products in as many ways as possible, as quickly as possible. Long waits in lines, insufficient tellers, excessive bureaucracy, unclear procedures, or rude treatment by the staff will turn away savers. Managers can minimize these unfavorable effects by training staff and by preparing systems to provide timely and accurate responses to client inquiries.

Linares stresses the importance of client relations, particularly in the context where an institutional response is required. He states that good client relations involve establishing policies that define how an institution will deal with and respond to clients—developing a client-first attitude among all staff, sensitizing staff to client needs, and training staff to respond to clients.

After safety, convenience is the second priority that savers establish as criteria for where they place their savings. For most savers, convenience is characterized by physical proximity, hours of access, transaction requirements or costs, speed of transactions, and product access. The physical proximity of the savings institution facility determines the cost and time required for the saver to go to the deposit facility. For many vendors, time away from their business has a high opportunity cost. For many small savers, the cost of paying for transportation from their locale to a distant office may exceed the average small deposit. Savings institutions respond by locating their offices in high-traffic markets or town centers and by opening minimal infrastructure branches to serve rural communities and urban centers.

The savings institution must provide service hours that are compatible with the schedules of savers in the local market. Savings institutions should offer service on weekends, extend evening hours, or open service windows to provide minimal services when the lobby is closed. Convenient access also requires an adequate physical layout of space, sufficient human resources, and simple, streamlined procedures.

Counting the Costs of Savings Mobilization

Richardson and Oliva engage in the debate about whether or not providing savings services to the poor is feasible. The authors present a methodology that draws from existing approaches to costing to orient readers to the critical areas that should be analyzed in determining the costs of savings mobilization. To demonstrate the feasibility of savings mobilization, they present findings from their recent study in which they investigated two questions. First, is savings mobilization a viable alternative to borrowing from external credit sources in order to fund loan portfolios? Second, is microsavings mobilization feasible?

While the financial costs of savings are easily identifiable, the non-financial costs of savings can be difficult for managers to uncover. Richardson and Oliva conducted a practical costing exercise of direct and indirect administrative costs in 15 credit unions to discover what it costs these institutions to provide savings services to their members and clients. Based on their findings, they present a costing methodology that readers can apply in their own institutions.

The authors selected 15 credit unions from Bolivia, Ecuador, Guatemala, and Nicaragua that represented a cross-section of large, medium, and small credit unions, with varying levels of experience, in both rural and urban locations. The authors reviewed three main areas of costs: financial costs, direct administrative costs, and indirect administrative costs. These costs are summarized in Table 1.3.

Table 1.3 Three Main Areas of Costs Related to Savings Mobilization

Financial Costs	Direct Administrative Costs	Indirect Administrative Costs
Interest	Human resources	Human resources
Insurance	Marketing	Administrative services
Taxes	Commissions that are directly related to savings mobilization	Depreciation
Dividends		Protection

Richardson and Oliva use a hybrid model to allocate the indirect administrative costs related to savings mobilizations among departments in an institution. They allocate costs for supplies, insurance, computer maintenance, and depreciation according to the volume of savings transactions in a year. They allocate the costs of telephone, electricity, gas, water, janitorial services, office maintenance, and depreciation according to the percentage of physical space dedicated to savings mobilization. They allocate the personnel costs of employees who are indirectly or partly involved in savings-related activities according to the time spent on these activities.

Richardson and Oliva's findings suggest economies of scale in savings volume. The exercise indicates that the percentage of direct and indirect administrative costs of savings mobilization drops significantly when a credit union reaches the $1 million threshold of savings volume. While the administrative costs were higher in the small credit unions, the total costs of savings mobilization were still competitive with most commercial sources of credit. Even for the small Guatemalan credit union with the highest administrative costs, the financial costs of 9.1 percent plus the administrative costs of 8.4 percent (for a total cost of 17.5 percent) are competitive with and marginally lower than the commercial borrowing rate of 19 percent. For the medium and large credit unions, there is a greater economic advantage in the lower costs of mobilizing savings versus borrowing from external credit sources. For all 15 credit unions in the four countries, the costs of mobilizing savings averaged about 5 percent less than the commercial borrowing rate. There were economic advantages that favored savings mobilization, ranging from a low of 1.22 percent to a high of 9.39 percent, in all of the credit unions.

The authors advocate that the feasibility of microsavings mobilization is found in the structure of the deposit base. They present the deposit structure of four Guatemalan credit unions to show that 89 percent of the savings accounts had balances of less than $300. These small accounts provided only 8 percent of the volume of resources used to fund the loan portfolio. Eighty-two percent of the volume of funds came from savings accounts with balances greater than $1,000. The authors conclude that microsavings mobilization is feasible if balanced with larger savings accounts, because the larger accounts provide the volume to fund lending activities and spread the fixed costs of offering savings services to all income groups.

Richardson and Oliva conclude that a savings institution must diversify its client base—beyond the poor—to mobilize the volume of savings needed to fund growing loan portfolios and to spread fixed costs. Their study of credit unions in four countries suggests that the large volume of savings resources used to fund loan portfolios comes from clients who are net savers, clients who save for the sake of saving. This group of clients differs from the traditional net borrowers of most MFIs. Like the other authors, Richardson and Oliva conclude that the success of a savings mobilization program depends on the ability of an institution to reach out to different segments in the marketplace and attract clients from varying income levels.

Savings Mobilization Case Studies in Latin America

Case studies written by practitioners demonstrate how credit unions in Nicaragua and Ecuador were able to implement successful savings programs to grow their institutions and better serve their communities, even during times of crisis.

The case study of Nicaragua tells the story of how credit unions involved in WOCCU Nicaragua's Rural Credit Union Program (RCUP) were able to implement financial disciplines, strengthen their institutions, create new images, develop targeted savings products, and launch successful marketing campaigns. These measures enabled the credit unions to increase their outreach in one of Latin America's poorest countries. This example of the Nicaraguan credit unions not only illustrates the implementation of the methodologies discussed in the previous chapters, but also underscores the fact that a solid framework is key to successful savings mobilization.

Two case studies examine the experience of credit union savings mobilization in Ecuador. Izurieta tells the story of how two Ecuadorian credit unions implemented financial disciplines, attained financial stability, and marketed that stability so that when the formal financial system underwent crisis, local Ecuadorians considered credit unions to be sound institutions in which they could safely place their savings.

Cabezas presents empirical evidence to show the success that 14 credit unions in Ecuador achieved in mobilizing savings. He compares the performance of seven credit unions supervised by the Bank Superintendency with seven credit unions still supervised by the cooperative agency. Cabezas finds that the group supervised by the Bank Superintendency tended to be larger, with higher levels of savings mobilized, and lower interest rates paid on savings. He observes that all of the credit unions drew on certain fundamental elements in their savings mobilization strategies: benefits for members and clients, affordable interest rates on loans, high-quality client service, positive institutional image, trustworthy managers and directors, promotional campaigns, contributions to the development of the local market, branch opening, and strict liquidity reserves. Cabezas' member survey creates member profiles for the credit unions in Ecuador.

The Toolkit

Finally, the authors, together with additional contributors, offer several practical tools that readers can use in their own savings mobilization efforts. The toolkit provides worksheets, surveys, and forms that have been used in credit union strengthening programs. The tools provide guidance for evaluating management, calculating interest, instituting internal controls, managing liquidity, managing assets and liabilities, managing risk, setting up profit and loss simulations, developing marketing campaigns, conducting surveys, and determining the costs of savings mobilization.

In Conclusion

MFIs that seek to mobilize savings must have the vision, commitment, and disposition to attract voluntary savings. Each institution must adapt its own business strategy, culture, policies, procedures, and product offerings to provide savings services that are competitive and that meet the needs of the local market. For credit-only institutions that want to initiate savings programs, this decision will require a reorientation of the service delivery mechanisms and of the culture of the institution. Credit unions and other savings institutions that want to expand their savings mobilization efforts to increase the funds available to them, improve service provision to clients, and increase their local market share will have to examine their existing operations to see how they can better provide the key features that savers seek: safety, convenience, and returns. Although savings mobilization presents serious challenges, the institutions that choose this path will find themselves able to provide higher quality services to clients of all income levels and greater access to financial services for their low-income and poor clients.

The methodologies and tools described in this book are best practices that have grown out of the experiences of the authors and their colleagues in credit unions throughout Latin America. One cannot address all of the topics related to savings in a comprehensive manner in one volume; for example, accounting, credit analysis, and governance are just a few of the areas that have profound influences on the success of a savings mobilization program. The authors have addressed these topics as they relate specifically to savings. These key functions of financial management are covered more fully in a variety of microfinance resources. Readers are encouraged to consult other practitioner-focused resources in these areas. PACT Publications (www.pactpublications.org) offers several publications on its website. The CGAP Microfinance Gateway (www.microfinancegateway.org) has an extensive library of resources. For further information on financial management specific to credit unions, readers are invited to visit the WOCCU website (www.woccu.org).

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Chapter 2 Institutional Preconditions: Testing Readiness and Achieving Sustainability

Mark Cifuentes

Savers need to be able to trust that an institution will safeguard their deposits. When clients deposit their savings in an institution, they assume the risk of not getting the full value of their savings back when they withdraw the funds at a later date. Savers receive payment in the form of interest accrued on deposits in return for taking this risk and for allowing the savings institution to use their funds. Savers want to know that the full value of their deposits will be available when they want or need them. They have also come to expect a real return on their deposits.

In offering savings products, an institution takes on the responsibility of protecting the deposits. Many existing microfinance institutions (MFIs)—non-governmental organizations (NGOs), finance companies, credit unions, or others—are not in the position to begin mobilizing savings responsibly. They first must put in place the structures and disciplines that will enable them to become safe and sound institutions, capable of protecting the savings they mobilize.

Electing to mobilize savings is a strategic, long-term decision. Not only does building trust among clients require significant time and resources, but also preparing the institution to adhere to the financial disciplines to protect savings requires a committed effort. The critical elements for safe and sound savings mobilization take in both environmental and institutional elements. The environmental elements include:

- Enabling macroeconomic environment;
- Legal framework and authority to mobilize savings; and
- Effective supervision.

The institutional elements include:

- Market orientation;
- Effective governance;
- Transparent accounting reporting system;
- Sound financial management;
- System for monitoring financial performance;
- Professional capacity;
- Convenience of service;
- Safe and sound image;
- Market feasibility; and
- Business planning.

Financial institutions are not expected to complete all of the steps or adhere to all of the disciplines outlined in this chapter before initiating a savings program. If that were the case, few MFIs would ever be ready to mobilize savings. Nevertheless, there are seven minimum preconditions an institution must meet *before* mobilizing savings from their members or from the public. These preconditions are:

1. Legal authority granted by the government to mobilize savings;
2. An up-to-date accounting system;
3. Accounting books that are closed monthly, no later than the tenth working day after the end of the previous month;
4. Full provisions for all loans delinquent more than 12 months and for all delinquent loans where the term is past due;
5. A delinquency tracking tool in place and working;
6. A liquidity reserve of 10 percent of total deposits; and
7. Internal control policies and procedures established and implemented.

These seven preconditions, discussed throughout the chapter, establish a level of security in the institution to an extent that savers who place their funds there can be reasonably sure that they will recoup the full value of their deposits. Once an institution meets these preconditions, it can begin mobilizing savings while it continues to put in place all of the critical elements that ensure long-term safety and soundness. The steps presented in this chapter will not, indeed cannot, be implemented in a linear manner; that is, one after the other in sequence. Rather, some steps will be taken at the beginning, others at different stages during the process, and still others as a result of savings mobilization. The steps discussed here are offered as guidelines for practitioners to use in setting goals and managing their institutions.

This chapter draws on lessons learned from the experience of credit unions in Nicaragua, where formerly credit-focused institutions transformed themselves into full financial intermediaries capable of smoothing the flow of funds between net savers and members who need loans. The chapter outlines the steps readers can take to (1) assess whether their own institutions are ready to mobilize savings responsibly and (2) prepare their institutions to mobilize savings.

Environmental Elements

In credit union experience worldwide, three key elements stand out as environmental preconditions for mobilizing savings: manageable inflation, legal authority, and effective supervision. Relative political stability is also necessary for financial intermediation to function.

Manageable Inflation

A stable macroeconomic environment enables financial intermediation. This stability allows an institution to operate at rates that are viable and sustainable, protecting the real value of client savings and earning real returns on loans. When inflation rates are high—12 to 60 percent—savings institutions can use a number of strategies, including variable rates, hard currency value-pegging, and short-term lending, to protect the real value of savings. Inflation rates between 60 and 120 percent allow for only limited short-term operations. When inflation rates exceed 120 percent, savings mobilization and financial intermediation break down.

Legal Authority

Savings mobilization is an agreement, or pact, between two parties: the institution receiving the deposits and the individual placing deposits in that institution. Savings services need to operate within an established legal framework; that is, the law specifies the criteria under which institutions may receive deposits from members or from the public. The legal framework should also identify what recourse savers have to recover their deposits from savings institutions in times of crisis.

An institution must have legal authority to mobilize savings. An institution that is not legally authorized to accept deposits should not initiate a savings program. The penalties for mobilizing savings without the legal authority vary by country, but most often an institution loses its operating authority. A number of options are available to institutions that want to mobilize savings, but do not have the legal authority to do so. They can:

- Convert to a type of institution that has the legal authority;
- Become agencies of institutions that already have the legal authority; or
- Lobby lawmakers to gain the legal authority through changes in legislation.

Effective Supervision

Institutions will be able to mobilize savings responsibly and more effectively within the safety of an adequate regulatory and supervisory framework. Institutions that mobilize voluntary deposits should be supervised by the government regulatory agency responsible for supervision of the financial sector. Effective supervision requires a sound legal system, formalized audit requirements, supervisory monitoring capacity, an established regulatory framework, and authority to enforce the law. Before starting a savings program, managers must investigate key areas such as capital adequacy requirements, liquidity requirements, accounting and reporting standards, audit procedures, and branching regulations to make sure that the institution can comply with the legal requirements for savings institutions.

In cases where no regulatory framework exists, MFIs may proactively advocate for sound regulatory principles and supervisory practices with legislators, regulators, and other policymakers. It is not advisable for an institution to mobilize savings without external supervision. Nevertheless, in the absence of effective supervision, an institution may have to self-regulate by adhering strictly to international financial standards and disciplines, such as those presented in the PEARLS discussion later in this chapter. Self-regulation is not a long-term substitute for effective supervision by a government regulatory agency. It is an option for institutions that are safe and sound, but located in countries where third-party supervision is not yet established.

Market Orientation

Market-oriented operations benefit savers by pricing (or re-pricing where necessary) financial products to provide market returns. This allows the institution to expand the variety of financial services offered, as it responds to competitive pressures in the local financial market. Market-oriented credit unions have found that low-balance, withdrawable savings products are highly demanded in the microfinance marketplace.

Effective Governance

It is the simultaneous presence of savers (who provide the funds) and borrowers (who borrow the funds) that forms the basis for a self-sufficient and balanced financial intermediary. Yet the two groups have conflicting objectives. Net savers demand high deposit rates and strong prudential disciplines to protect their savings, while net borrowers tend to demand low loan rates, low transactions costs, and easy access to credit.

The quality of the savings services offered, combined with the loan screening and collection policies, determine the proportion of net savers to net borrowers in an institution. In member-controlled institutions, this proportion is reflected in the nature of the directorship—balanced or borrower-dominated. Balanced institutions with high-quality savings services will attract net savers as well as net borrowers. The net savers will exert pressure upon management to protect their savings. Borrower-dominated institutions tend to put savings at risk, discourage net savers, and attract those looking for cheap loans, effectively perpetuating the borrower domination.

The threat of widespread deposit withdrawal due to lack of saver confidence in an institution should keep managers on track, since significant withdrawals would eliminate the base of funds in a self-sustaining savings institution. In theory, this threat should force managers to govern effectively and adhere to sound financial principles in order to protect client savings and the sustainability of the institution. Nevertheless, the threat of deposit withdrawal is not always sufficient to ensure that managers will operate with financial discipline. At the institution level, rigorous bylaws and clear policies and procedures are required to establish prudential operating standards. At the state level, third-party supervision is necessary to uphold prudential norms and protect public savings.

Bylaws

The bylaws should be designed to provide flexibility for management, establish prudential financial disciplines, control conflicts of interest, and clarify roles and responsibilities of the parties who govern a savings institution. Bylaws set out clear rules that establish prudential standards and hold managers responsible for financial performance. The bylaws establish financial disciplines, covering institutional capital reserves, liquidity reserves, provisions for loan losses, and write-offs. The bylaws can also outline the principles of operation, such as principles that govern rates of return on savings and interest rates on loans. They do not, however, specify numbers or set controls on interest rates.

Roles and responsibilities. Bylaws outline the roles and responsibilities of the board of directors, managers, and committees. If responsibilities are not clearly defined, managers may be unable to respond quickly to opportunities or problems. Undefined roles and responsibilities in an institution produce operational inefficiency. An inefficient decision-making process may inhibit an institution's ability to respond quickly to market changes in pricing, to manage liquidity, or to protect savings. Oversight is the responsibility of the board of directors. Bylaws should limit the involvement of board members in day-to-day operations

Institutional bylaws. Standard elements of financial institution bylaws establish: registration requirements; mission statement; governance structure; admission, responsibilities, rights, and loss of clients; operating principles and financial disciplines; annual general meeting requirements in the case of credit unions; quorum; responsibilities of the board of directors, general manager, and officers; supervision committee and other committees (such as credit or education); and terms of dissolution or liquidation.

and direct their attention to policy creation and the direction of the institution as a whole. Bylaws establish managerial responsibilities such as implementing the policies, overseeing the budget, administering daily operations, reporting to the board of directors, and hiring and managing staff.

Control conflicts of interest. Bylaws, together with policy and procedure manuals, establish ethical codes of conduct and control insider loans to prohibit conflicts of interest. For example, to be a director, a person must be free of any relation with employees, should not have a contractual working relationship with the institution, and may not have a delinquent loan with the institution. A board member is not permitted to participate in any loan or service decisions related to his or her own account. To minimize conflicts of interest, savings institutions can:

- Institute personnel policies to hire, train, and pay staff.
- Establish policies for the election and training of officials.
- Make sure that all officials and staff understand and adhere to policies and procedures.
- Develop a system to supervise the implementation of policies and procedures.
- Ensure the proper rotation of personnel responsibilities.
- Segregate operational functions.

Accounting System

Before an institution mobilizes savings, it should implement a transparent accounting system that follows generally accepted accounting principles and procedures. The system should be flexible in its capacity and rigid in its controls and standards. It must be cost-effective, promote accuracy, and increase efficiency.

Managers in an institution can take the following steps to establish an effective accounting system:

- Prepare an accounting manual.
- Evaluate the skills and expertise of the accountants on staff.
- Teach basic accounting courses and introduce the accounting nomenclature to accountants, staff, and board members.

- Integrate all auxiliary accounting records, the general ledger, member record cards, bank reconciliation, income statements, and balance sheets into the new accounting system.
- Standardize all forms so they are compatible with the new nomenclature.
- Implement and adhere to accounting closing dates.

In cases where an existing accounting system lacks the necessary nomenclature or adherence to required disciplines, the institution may run parallel accounting systems for three to five months while transitioning to the new system.

Transparency

Transparency is fundamental to credibility and confidence. In financial institutions, transparency is achieved through clear, easy-to-understand accounting and reporting systems. These systems provide managers, directors, government supervisors, and clients with information to monitor the financial management of a savings institution.

Nomenclature

The account nomenclature, or system of accounts, must be consistent with international accounting standards as well as with those established by the government regulatory agency. If the nomenclature of accounts used by the savings institution has not been approved by the appropriate regulatory body, managers should initiate discussions with the financial regulator to ensure that the nomenclature meets all legal requirements.

Adequate accounting nomenclature includes:

- Detailed chart of accounts with clear definitions;
- Definition of reserving and provisioning accounts for loan or investment losses;
- Definition of depreciation and methods of depreciation;
- Definition of revaluation of assets (savings institutions should not revalue assets, even if the law does permit it, since doing so overstates them);
- Levels of accounts;

- A system that does not allow loans to elected officials or employees to be accounted for as accounts receivable;
- Definition of and distinction between transitory capital and permanent institutional capital; and
- Use of cash, not accrued, accounting for loan interest income (interest on loans should not be counted as income until it has been collected).

Components of an Effective Accounting System

Once the accounting nomenclature has been established, managers should make certain that the key components of an effective accounting system are in place. Such a system includes:

- Ledger cards;
- Procedures for payments and disbursements;
- Journal and cash records;
- General ledger;
- Trial balances; and
- Balance sheet and income statement.

Managers should ensure that the new accounting system promotes transparency and adheres to the requirements set forth in local laws and regulations.

Financial Management

As part of beginning or accelerating a savings mobilization program, an institution must establish prudential financial management disciplines as standard, well-understood, and staff-supported practices. These disciplines should be formalized in policy statements and implemented in practice. Financial disciplines are interdependent and mutually reinforcing; therefore, they should be implemented as an integrated system, not in a way that addresses some risks but not others.

Table 2.1 shows core financial disciplines that ensure prudential financial management.

Table 2.1 Prudential Financial Management

Financial Discipline	Target
Delinquency	Less than 5 percent of total loan portfolio over 30 days delinquent
Loan-loss provisions	100 percent of all delinquent loans over 12 months and 35 percent of all delinquent loans one to 12 months
Loan write-offs	100 percent of all delinquent loans over 12 months
Net institutional capital	At least 10 percent of total assets
Liquidity reserves	10 percent of total savings deposits
Non-earning assets	Less than 5 percent of total assets
Operating expenses	Less than 10 percent of average total assets

Loan Portfolio Quality

As an institution mobilizes savings, liquidity increases and the funds are directed into the community as loans. It is critical that savings institutions have in place effective policies and procedures for credit screening and risk analysis to ensure that the loans financed by client savings are collectible. Credit risk management should include strict delinquency monitoring, loan-loss provisioning, and collection procedures.

Credit policies and procedures. Loans must be disbursed according to established credit policies and procedures. Written policies set the levels of authority for granting loans. Policies also define the types of loans offered, loan terms, interest rate policies, loan ceilings, and concentration limits. Lending policies provide guidelines for eligibility, information requirements, security and collateral requirements, and terms for review.

Credit policies promote institutional soundness by assigning credit decisions to a professional staff. A technical credit committee made up of the general manager, the credit manager, the loan officers, and, if necessary, an elected official implements the credit policies and procedures as approved by the board of directors. To minimize risk and facilitate the loan approval process, the credit policies establish tiers of loan approval. Each member of the technical credit committee has the authority to approve loans within certain limits. The technical credit committee as a group approves large, long-term, or high-risk loans. The board considers loans to directors, other elected officials, and staff (if allowed), as well as loans above a certain amount.

Loans are disbursed according to standardized procedures. Loan applications are standardized to provide clear information for credit approval and post-disbursement follow-up. Staff verifies the authenticity of documents and signatures. Members of the board and employees who do not have direct credit responsibilities are prohibited from influencing loan approvals and may not serve as guarantors of client loans. Internal controls separate credit functions so that employees approving loans are not the same as those disbursing the loans.

Credit analysis. Effective credit screening practices improve asset quality and protect client savings. Credit risk is measured most accurately when loans are approved and processed on the basis of the "five Cs": character, capital, capacity, collateral, and conditions.

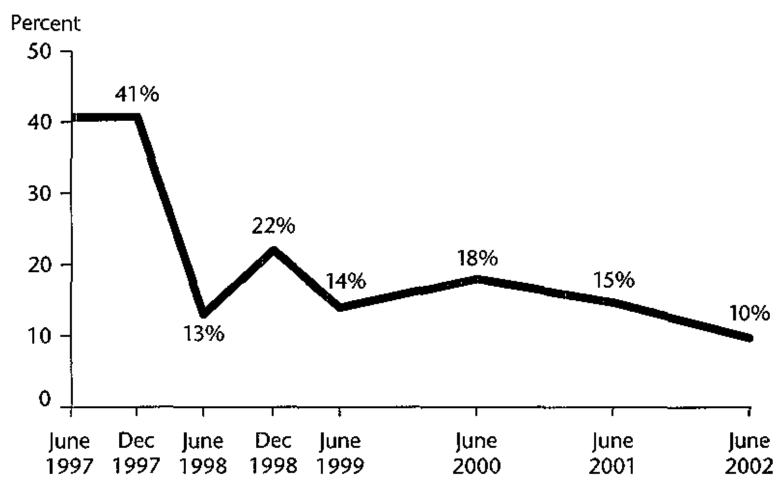
- **Character:** Examines the historical background of the borrower and judgment on his or her willingness to repay; that is, employment, other income-generating activities, education, and performance on past loans.
- **Capital:** Verifies the value of all the borrower's fixed and financial assets.
- **Capacity:** Evaluates the financial condition of the borrower to see if he or she has sufficient income to pay this and other outstanding loans.
- **Collateral:** Assesses the material goods owned by the borrower that can be used to recover the value of the loan in the case of default.
- **Conditions:** Analyzes the economic circumstances and other social conditions of the borrower, and evaluates the purpose of the loan.

Collections policies and procedures. Collections policies are established at the same time as credit policies. Savings institutions that provide credit must establish and implement loan recovery procedures to protect the value of deposits. Recovery strategies include frequent follow-up to gauge progress on pending collections and to

Collections in Nicaragua. Beginning in 1996, a group of 14 Nicaraguan credit unions embarked on a rigorous institutional strengthening program. At the start, these institutions lacked the financial disciplines to undertake a savings mobilization program. They relied heavily on external credit to fund loans for members. In 1996, these institutions were insolvent with high loan delinquency levels. External funds were quickly drying up as donors lost confidence in the credit unions. The institutions adopted the necessary disciplines to eventually mobilize savings, even though many people believed that the poor citizens of Nicaragua were too poor to save.

The consolidated delinquency in the eight credit unions that started the project (the other six joined the following year) was more than 60 percent. After implementing the financial disciplines, instituting aggressive collections, and improving the loan screening process, the institutions reduced delinquency to 13 percent by June 1998. With the destruction of agricultural crops and small enterprises wrought by Hurricane Mitch in October 1998, consolidated delinquency of the affected credit unions rose to 28 percent by May of 1999. An intense focus on collections and improved risk analysis in credit decisions reduced consolidated delinquency to 10 percent by June of 2002.

Figure 2.1 Delinquency in 14 Nicaraguan Credit Unions



prevent new delinquencies. Follow-up should be proactive; for example, financial institutions may send reminder notes or visit the clients who have tendencies to become delinquent before payments are due. These friendly reminders serve to reduce delinquency and build positive client relationships.

Write-offs. Credit policies should include requirements for loan write-offs and procedures for accounting for recoveries. To write off a loan does not mean to forgive a loan. Loans should be written off against the loan-loss reserves when (1) they have been delinquent for longer than 12 months, or (2) when the term of the loan is past due. Writing off delinquent loans allows an institution to maintain a clean balance sheet. As loans are written off, they are sent to lawyers for legal action and collection. Loans written off but then recovered are reentered through the income statement as loan loss provisions. If an institution is fully provisioned at the time of recovery, then collected loans are registered as non-operating income.

Loan income reporting. In addition to delinquency reporting and loan portfolio clean-up, accurate loan income reporting is part of protecting client deposits. Many financial institutions accrue interest on delinquent loans, reporting it as it would have been earned on the regular payment of the loans. However, interest is not income until it is collected. Accrued interest accounting on uncollected loans inflates income reported where it does not exist. To avoid this, savings institutions should record loan interest earnings on a cash basis when they are actually received.

Financial lines of defense. A savings institution protects the value of deposits through three financial lines of defense: loan loss provisions, institutional capital, and paid-in shares. Provisions are established to protect savings against observable risks; that is, loan losses that can be predicted by observed delinquency. If non-performing loans are not recovered, the savings that funded those loans will be lost. For that reason, savings institutions create provision expenses on the income statement.

Provisions are created as a percentage of delinquent loans. A savings institution should create provisions for 100 percent of loans delinquent more than 12 months because these loans are probably unrecoverable. Provisions should be created for at least 35 percent of loans delinquent less than 12 months. Loans less than 12 months delinquent are more likely to be recovered, and hence, require less provision. Loan-loss provisions are credited to the loan loss reserve account on the balance sheet.

Many risks are not observable by monitoring delinquency, such as risks that stem from unexpected losses or systemic shocks. A savings institution builds a second line of defense in reserves retained from earnings, or institutional capital. Institutional capital (capital reserves + retained earnings) should equal at least 10 percent of total assets. Institutional capital is a permanent and non-withdrawable source of capital that can cover operating risks and losses without impairing savings. It can also be used to provide security during a period of macroeconomic instability or during a banking crisis. In addition, institutional capital generates earnings for the institution when it is invested.

In credit unions, members invest shares as risk equity in the institution. In cases where provisions and reserves are not sufficient to absorb losses, these paid-in shares provide another line of defense before member savings are impaired. Common stocks provide this third line of defense in privately-owned institutions.

If a savings institution does not create provisions for loan losses and does not have sufficient institutional capital to back deposits, then savers risk losing the value of their deposits, in proportion to the inadequate level of protection (provisions + capital reserves). Table 2.2 illustrates the point.

In Table 2.2, the financial institution does not have adequate provisions or institutional capital reserves, which reduces the value of the client deposits by $10. This loss in the loan portfolio means that the savings on deposit are now worth $90 instead of $100; savers will recoup only $0.90 for every $1.00 deposited. A well-disciplined financial institution would have had $18 in accumulated provisions and institutional capital to reduce the savers' exposure to delinquency.

Aging the delinquent loan portfolio. In order to be able to create adequate provisions, savings institutions must first age their delinquent loan portfolios. Financial institutions should follow the legal standard for aging their loan portfolios; in most countries, these standards are defined by the central bank. As shown in Table 2.2, delinquent loans put

Table 2.2 Losses Due to Unprotected Delinquency Over 12 Months

a.	Total client savings on deposit	$100	
b.	Loans extended to borrowers	90	
c.	Delinquency of 20 percent (b x .20)	18	
d.	**Total accumulated provisions**	**4**	PROTECTION
e.	**Total institutional capital**	**4**	PROTECTION
f.	Potential losses (exposure to savers) due to unprotected delinquency [(c – (d + e)]	10	
g.	Value of total client savings on deposit (a – f)	90	

savings deposits at risk. When a client misses one payment, the balance of the entire loan is at risk. Given that provisions offset the risk of nonpayment, they should be created for the whole loan amount when even one payment is delinquent. Since the likelihood of recovery decreases as delinquent loans age, provisions are defined by the age of the delinquent loans to ensure adequate levels of protection.

There are two ways to create loan loss provisions based on the aging of the portfolio. In some cases, an aging scale is the basis for provisioning. Figure 2.2 shows how provisions are created for a higher percentage of older loans.

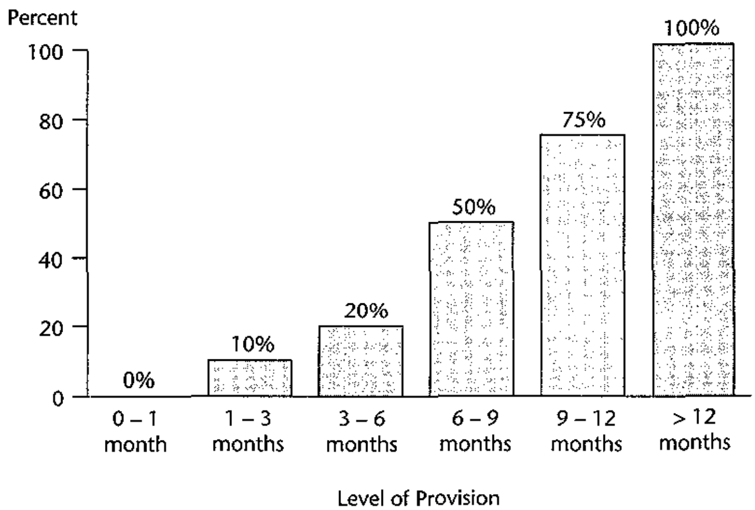
In other cases, provisions are created for 35 percent of loans delinquent one to 12 months and for 100 percent of all loans delinquent more than 12 months. Figure 2.3 shows how provisions are created in this type of system.

An institution may employ either method of provisioning to offset loan delinquency risk. WOCCU recommends the second method because it is easier to calculate, particularly for institutions lacking computerized management information systems that can automatically age delinquent loans.

Asset Quality and Earnings on Assets

Assets can be separated into two categories: earning and non-earning. Earning assets generate the income needed to pay financial costs and operating expenses. Non-earning assets include fixed assets, which do not generate income, as well as delinquent loans, which no longer generate income. Fixed assets decrease the amount of earning assets an institution relies on to earn income. If an institution finances the purchase of fixed assets with cost-bearing liabilities, such as client savings or external credit, then the cost of those fixed assets is higher than if it

Figure 2.2 Aging Scale for Loan Loss Provisions



had been financed by institutional capital (zero-cost funds).

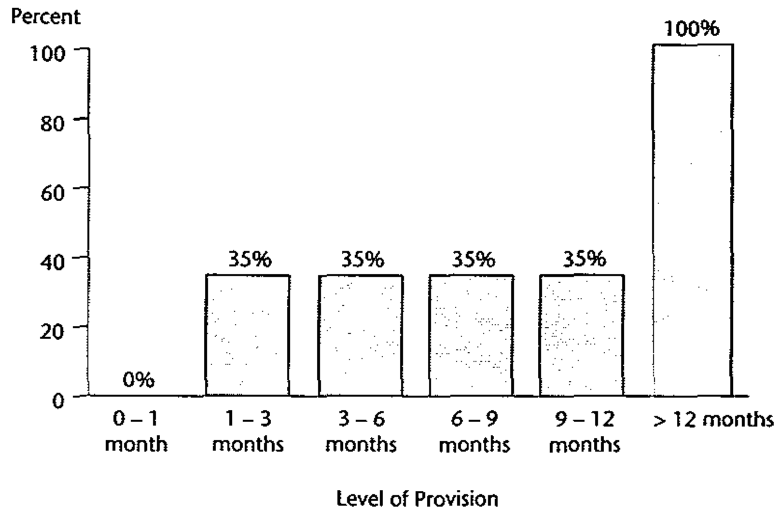
Since loans should generate the highest returns of all assets, loans as a percentage of total assets should be high to maximize profitability. Short-term and long-term investments generate returns, diversify risk, and help maintain sufficient liquidity levels for response to client withdrawal demands.

Other Financial Management Requirements

Cash flow analysis. Cash flow analysis identifies sources of incoming funds and determines how those funds are used; it explains changes in cash accounts. Cash flow analysis enables managers to determine if there is or will be sufficient liquidity to generate the income necessary to cover financial and administrative costs, disbursements of new loans, and savings withdrawals. Institutions should not raise savings and then use them to pay operating expenses; this would impair savings and raise costs to the institution. Managers can make better decisions and better determine when to seek external financing if they know the cash flow in their institutions.

Liquidity management. An institution's ability to mobilize savings depends on the confidence of local clients. If there is a perception that

Figure 2.3 Standard Level for Loan Loss Provisions



the institution lacks the funds to pay out savings, then both small and large savers will lose confidence and withdraw their deposits. A savings institution should maintain cash liquidity reserves of at least 10 percent of withdrawable deposits to ensure response for withdrawal demands. For large accounts above a certain amount (determined by management and the board of directors), liquidity reserves of 20 to 25 percent of withdrawable deposits are required to offset the concentration risk.

Asset-liability management (ALM). Smaller savings institutions tend to provide short-term loans financed by short-term liabilities, such as savings. As financial institutions become more sophisticated and clients demand longer-term loans, managers must ensure that an appropriate ALM program is used. If an institution mismatches assets and liabilities, it runs the risk of having insufficient liquidity to return funds to savers when their deposits mature. For example, an institution cannot fund a five-year housing loan with a deposit product that will mature in one year. An ALM program tracks the rotation of the savings and loan portfolios. It also matches loan products to savings products by age, risk, and size to ensure that loans are financed by liabilities that can sustain the required funding levels for the full terms.

Computerization. Computerization of accounting and management systems can significantly reduce the transaction costs associated with providing savings services, especially for small accounts where transaction costs are a large proportion of the balance. Computerized accounting systems improve the accuracy and transparency of financial information and, as a result, the quality of management and monitoring. At the same time, computerization is not a precondition to mobilizing savings. Institutions with manual operations can launch and maintain successful savings programs, but require increased human resources to service the greater number of accounts and clients. In deciding whether to invest in computerization, managers in a savings institution must weigh the increased fixed-asset and operating costs against the potential gains.

Monitoring Financial Performance

An institution should adopt a standardized, well-balanced financial monitoring system before it begins a savings mobilization program. WOCCU's PEARLS financial performance monitoring system was derived from the original CAMEL model and adapted for credit unions in varying stages of development. PEARLS is a quantitative tool that attempts to remove the subjective elements of evaluation. Other monitoring systems, such as ACCION's CAMEL model, include qualitative measures of evaluation and indicators that are specific to microfinance institutions.

PEARLS

WOCCU developed PEARLS in 1990 as a tool to guide the financial management and to evaluate the operations of credit unions in Latin America. Since then, PEARLS has evolved into a standardized management and supervisory tool used to monitor and evaluate credit unions worldwide. The PEARLS system is made up of 44 financial ratios (including the 13 key ratios bolded in the table) that provide a complete measure of a credit union's financial performance. The system is also applicable to other savings-based MFIs. Each element of PEARLS looks at a critical element of financial operations:

P = Protection

E = Effective Financial Structure

A = Asset Quality

R = Rates of Return and Cost

L = Liquidity

S = Signs of Growth

Before an institution mobilizes savings, it should establish financial disciplines to protect savings from risk. The most obvious risk to a financial institution stems from potential losses caused by loan delinquency. The **Protection (P)** indicators measure whether the institution has adequate provisions to absorb expected loan losses. P indicators monitor the solvency of the institution; that is, its ability to return the full value of deposits to savers.

The **Effective Financial Structure (E)** of a savings institution is constantly changing, particularly under rapid growth conditions. The E indicators monitor the structure of both sides of the balance sheet—they show the sources and uses of funds. On the asset side, indicators monitor where the funds are invested: loans, liquid investments, financial investments, or non-financial investments. This helps managers use funds where they will earn the highest returns. On the liabilities side, the indicators show where the primary sources of funds are: deposits, shares, external credit, or institutional capital. As a credit union evolves in response to market conditions, its financial structure changes, moving from dependence on shares and external credit to depending on voluntary savings deposits to fund assets. This evolution is captured in the E indicators.

Asset Quality (A) indicators measure the problem areas that have the greatest impact on profitability. Savings-based institutions must generate income to pay returns to savers if they are to continue to attract deposits. When loans become delinquent, when fixed assets are high in relationship to total assets, or when an institution invests savings in non-earning assets, the institution will fail to produce the income necessary to pay financial costs and operating expenses.

The **Rates of Return and Cost (R)** indicators tell an institution what it earns on the various uses of its funds: loans, liquid investments, financial investments, and non-financial investments. The R indicators also reveal the costs that the institution pays to acquire the various sources of funds: savings deposits, shares, and external credit. This information enables managers to identify sources of funds that minimize financial costs and to match the returns on uses of funds with the costs of sources. The indicators provide a spread analysis of the gross margin, operating costs, provision costs, and net income.

Liquidity (L) indicators measure the ability of the institution to ensure that adequate liquidity is available to meet the withdrawal demands of savers and the disbursement demands of borrowers.

Signs of Growth (S) indicators measure the growth rates of membership, as well as the growth rate on both sides of the balance sheet. The comparative rates of growth in savings and loans tell the institution what impact—balanced or unbalanced—growth will have on liquidity and profitability. The S indicators allow managers to monitor the growth of institutional capital as required to maintain adequate capital levels of protection during periods of high growth.

Interrelationships. Each PEARLS indicator is interrelated with others. The following example demonstrates the relationships among indicators as savings increase. As Savings Deposits (S5) increase, then Total Assets (S11) will increase. This will require an increase in Net Institutional Capital (S9) to reach the goal of 10 percent of Total Assets (E9). Institutional Capital (S9) will grow if Net Income/ Average Assets (E12) grows. E12 will grow if the institution becomes more efficient, maintaining Total Operating Expenses/Average Total Assets (R9) at 5 percent or less. Another way to increase E12 is to decrease Total Loan Delinquency/Gross Loan Portfolio (A1), meaning that the Total Loan Loss Provision Expense/Average Total Assets (R10) would also decrease. The third way to increase E12 is by maximizing Total Gross Income Margin/Average Total Assets (R8). To maximize R8, an institution needs to ensure that its most profitable investments, Net Loans/Total Assets (E1), are performing. E1 is adversely affected by Liquid Investments/Total Assets (E2) and Financial Investments/Total Assets (E3). As more funds are invested in E2 and E3, less funds are available to invest in E1. But, E2 and E3 provide easily accessible funds and diversification of the investment portfolio to ensure that the institution has sufficient liquidity, ST Investments + Liquid Assets – ST Payables/Savings Deposits (L1), to meet the withdrawal demands of savers (L1 should be a minimum of 15 percent). Managers must constantly evaluate the effects that a change in one ratio will have on the other indicators so they can monitor the impact this change will have on the institution.

The PEARLS monitoring system evaluates the financial condition based on the information provided from the financial accounts. For PEARLS or any other financial monitoring system to generate accurate indicators, an institution needs to have a transparent accounting system with accurate account information. The goal of PEARLS is to promote balance, efficiency, and maximum return on assets in a financial institution. Table 2.3 sets out the PEARLS Monitoring System Indicators.

The goals in Table 2.3 are WOCCU's *International Standards of Excellence,* established specifically for credit unions. Annual targets for achieving these standards will vary depending on each savings institution's phase of development. As institutions strive to reach the goals, managers should evaluate progress quarterly.

Table 2.3 The PEARLS Monitoring System

Indicator	Description	Goal
P = PROTECTION		
P1	**Allowance for Loan Losses/Delinquency > 12 months**	**100%**
P2	**Net Allowance for Loan Losses/Delinquency 1-12 months**	**35%**
P3	Total Write-off of Delinquent Loans > 12 months	100%
P4	Annual Loan Write-offs/Average Loan Portfolio	Minimum
P5	Accumulated Loan Recoveries/Accumulated Loan Write-offs	100%
P6	Solvency (Net Value of Assets/Total Shares and Deposits)	>= 110%
E = EFFECTIVE FINANCIAL STRUCTURE		
E1	**Net Loans/Total Assets**	**70 - 80%**
E2	Liquid Investments/Total Assets	Maximum 20%
E3	Financial Investments/Total Assets	Maximum 10%
E4	Non-financial Investments/Total Assets	0%
E5	**Savings Deposits/Total Assets**	**70 - 80%**
E6	**External Credit/Total Assets**	**Maximum 5%**
E7	Member Share Capital/Total Assets	10 - 20%
E8	Institutional Capital/Total Assets	Minimum 10%
E9	**Net Institutional Capital/Total Assets**	**= E8**
A = ASSET QUALITY		
A1	**Total Loan Delinquency/Gross Loan Portfolio**	**<= 5%**
A2	**Non-earning Assets/Total Assets**	**<= 5%**
A3	Net Zero-cost Funds[1]/Non-earning Assets	> 200%

[1] *Zero-cost funds is equal to Non-interest Bearing Liabilities + Non-institutional Capital + Institutional Capital.*

Table 2.3 continued The PEARLS Monitoring System

Indicator	Description	Goal
R = RATES OF RETURN AND COST		
R1	Net Loan Income/Average Net Loan Portfolio	Entrepreneurial Rate
R2	Total Liquid Investment Income/ Average Liquid Investments	Market Rates
R3	Total Financial Investment Income/ Average Financial Investments	Market Rates
R4	Total Non-financial Investment Income/ Average Non-financial Investments	> R1
R5	Total Interest Cost on Savings Deposits/ Average Savings Deposits	Market Rates > Inflation
R6	Total Interest Cost on External Credit/ Average External Credit	Market Rates
R7	**Total Interest (Dividend) Cost on Member Shares/ Average Member Shares**	**Market Rates > = R5**
R8	Total Gross Income Margin/ Average Total Assets	Variable–Linked to R9, R11, R12
R9	**Total Operating Expenses/Average Total Assets**	**5%**
R10	Total Loan Loss Provisions/Average Total Assets	Dependent on Delinquent Loans
R11	Non-recurring Income or Expense/Average Total Assets	Minimal
R12	**Net Income/Average Total Assets**	**Linked to E9**
L = LIQUIDITY		
L1	**Short-term Investments + Liquid Assets – Short-term Payables/Savings Deposits**	**Minimum 15%**
L2	Liquidity Reserves/Savings Deposits	10%
L3	Non-earning Liquid Assets/Total Assets	< 1%
S = SIGNS OF GROWTH		
S1	Net Loans	Dependent on E1
S2	Liquid Investments	Dependent on E2
S3	Financial Investments	Dependent on E3
S4	Non-financial Investments	Dependent on E4
S5	Savings Deposits	Dependent on E5
S6	External Credit	Dependent on E6
S7	Member Shares	Dependent on E7
S8	Institutional Capital	Dependent on E8
S9	Net Institutional Capital	Dependent on E9
S10	Membership	> 12%
S11	**Total Assets**	**> Inflation**

Bold Denotes the 13 Key Indicators

CAMEL

The principal objective of the original CAMEL system was to provide an analytical tool for regulators to use when monitoring financial institutions. ACCION has developed a CAMEL monitoring system specifically for MFIs. The ACCION CAMEL framework analyzes and rates 21 quantitative and qualitative indicators. The key indicators are:

C = **Capital Adequacy:** Leverage, ability to raise equity, and adequacy of reserves.

A = **Asset Quality:** Portfolio-at-risk, write-offs, portfolio classification system, productivity of long-term assets, and infrastructure.

M = **Management:** Governance/management, human resources, processes, controls and audits, information technology, and strategic planning and budgeting.

E = **Earnings:** Adjusted return on equity, operational efficiency, adjusted return on assets, and interest rate policy.

L = **Liquidity Management:** Liability structure, availability of funds to meet credit demand, cash flow projections, and productivity of other current assets.

There are three main differences between the PEARLS and the CAMEL monitoring systems:

1. PEARLS uses strictly quantitative measures while CAMEL uses both quantitative and qualitative measures.
2. PEARLS evaluates the financial structure of the balance sheet to determine the effect on efficiency and profitability.
3. PEARLS measures growth rates so that managers can maintain effective financial structures and continually adjust with the impact of growth on the institution.

Whether an institution uses PEARLS, CAMEL, or another monitoring system, it must adopt a standardized, well-balanced system that enables managers to monitor financial performance *before* engaging in savings mobilization.

Returning to the case of the 14 Nicaraguan credit unions, Table 2.3 shows how we can use PEARLS indicators to evaluate the significant advances in the disciplines of these institutions.

Table 2.3 Financial Structure of 14 Nicaraguan Credit Unions

Indicator	Goal	June 1997	June 1998	June 1999	June 2000	June 2001	June 2002
E1: Net Loans/ Total Assets	70 - 80%	64%	66%	72%	79%	71%	69%
E2: Liquid Investments/ Total Assets	max 20%	4%	9%	12%	8%	16%	19%
E5: Savings Deposits/ Total Assets	70 - 80%	2%	7%	16%	26%	36%	52%
E6: External Credit/ Total Assets	0%	54%	33%	35%	35%	29%	19%
E7: Shares/ Total Assets	max 20%	12%	16%	13%	10%	8%	8%
E9: Net Institutional Capital/Total Assets	min 10%	- 4%	34%	29%	19%	19%	19%
A1: Total Delinquency/ Gross Loan Portfolio	< 5%	41%	13%	14%	18%	15%	10%

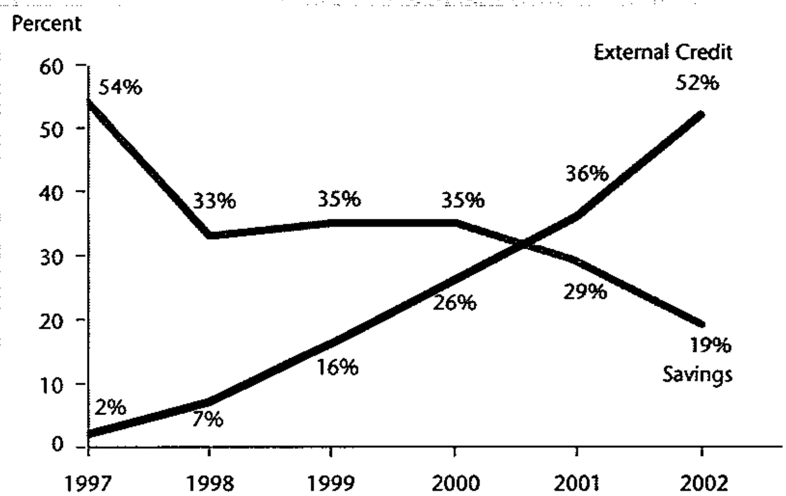
Table 2.3 indicates that in 1997, the 14 credit unions had mobilized savings equal to only 2 percent of total assets. By 1999, these same institutions met the preconditions to mobilize savings and began to market savings products. As a result, savings increased to 16 percent of total assets. By June 2002, the credit unions funded 52 percent of their total assets with savings.

At the beginning of the project, dependence on external funds was significant; external funds financed 54 percent of total assets. From 1997 to the present, the credit unions did not seek new external funds. By June 2002, external funds had decreased to 19 percent of total assets. Meanwhile, net institutional capital over total assets grew from negative 4 percent to positive 19 percent. This high level of institutional capital promotes confidence in the institutions.

Delinquency in the 14 credit unions dropped dramatically—from 41 percent in June 1997 to 10 percent in June 2002. The increase in delinquency after 1998 was due largely to the destruction wrought by Hurricane Mitch. Delinquency has been on the decline since 2000. As total assets have grown through the project, net loans have been maintained around the recommended 70 percent of total assets. This means that a larger amount of loanable funds have been distributed to the membership.

Figure 2.4 shows how the 14 credit unions funded their assets from 1997 through the first half of 2002. Figure 2.4 demonstrates two things. First, in 1997 external funds plus deposits financed 56 percent of total assets. At that time, dependence on external funding was high, at 54 percent of total assets. Deposits were insufficient to fund assets. By 2002, external funds plus savings deposits financed more than 71 percent of total assets, and savings alone financed 52 percent of total assets. By June 2002, these credit unions had cut their dependence on external funding to less than 19 percent and voluntary savings provided the primary source of funds. Second, it took these institutions about three years to match the level of savings to external funds. In other words, it took time for the credit unions to institute the financial disciplines, begin monitoring financial performance, and then build the confidence necessary to mobilize savings.

Figure 2.4 Asset Financing in 14 Nicaraguan Credit Unions



Professional Capacity

Institutions that plan to mobilize savings must have the vision, commitment, and disposition to attract voluntary savings. For a credit-only institution, mobilizing savings will require a reorientation of all staff. Institutions must develop the professional capacity of both managers and staff to administer savings products. In most cases, institutions will have to increase their staffing levels to handle the increased client traffic that comes with savings mobilization. Personnel policies are formalized to specify salary structure, employee benefits, job descriptions, rotation of personnel and recruitment, promotion, and release procedures.

Professional and Sound Management

Professional management is required to administer savings efficiently and preserve the value of deposits. Managers in a savings institution are not only responsible for implementation of human resource policies, but must also be qualified to manage financial intermediation. At a minimum, they must be able to:

- Understand a balance sheet and income statement;
- Implement PEARLS (or another monitoring system) and financial disciplines;
- Review policies and procedures annually;
- Manage finances according to a business plan; and
- Administer growth based on a marketing plan.

Staff Training

Many microcredit institutions begin savings mobilization in an effort to overcome liquidity shortages and dependence on external funding. Managers of these institutions should not assume that staff experienced in providing credit services will be able to provide savings services without training. Savers will demand higher levels of customer service than borrowers. Savers will also want to see safe handling and cautious management of their deposits. Financial institutions that are mobilizing savings for the first time or expanding through savings mobilization should train staff in customer service, cash management, marketing, interest rate management, and liquidity management. Employees should handle cash with strong ethical and professional standards, while maintaining a warm and personal approach with clients.

Convenience of Service

Convenience is a key factor in mobilizing savings. If the transaction costs of making deposits or withdrawals in an institution are high, then savers will be less likely to keep their savings in that institution.

Since the physical proximity of the savings institution determines the major cost and time required for savers to make deposits or withdrawals, institutions should try to locate their offices in high-traffic markets or town centers. Many credit unions open branches to serve high-traffic centers or outlying communities. Where financial institutions find themselves in poor locations or in little-trafficked sections of town, managers should consider moving to a section of town with greater market potential.

Savings institutions should provide competitive service hours compatible with the schedules of current and prospective clients in the local market. Many credit unions offer extended evening hours with window service after the lobby is closed and provide service on weekends.

Convenient access requires a well-planned physical layout to control public access. It also requires simple, streamlined procedures to provide savers with fast and cost-effective service. Time-consuming procedures will increase the costs of savings for clients. Borrowers will wait in lines to get loans, but depositors will be deterred by long lines and they will look for institutions with more convenient savings services.

The Importance of Image

In order to operate as a full financial intermediary between savers and borrowers, a former microcredit institution needs to expand its client

Microentrepreneurs engaged in trade often travel to various communities. As they travel, they need access to financial services, particularly savings services. For many, it is risky to carry cash. Credit unions establish national networks in which savers can deposit or withdraw funds from institutions in various towns. Credit union networks, such as the network established in Guatemala, offer a national network with more than one hundred points of service where savers from any one credit union can transact business at any credit union in the network. As discussed in Chapter 3, this type of network requires constant commitment to financial disciplines, policies, and performance standards, as well as mechanisms for the central clearing of transactions.

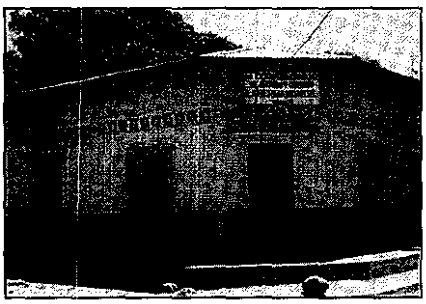
base to mobilize the volume of savings necessary to (1) develop a cost-effective savings program and (2) use savings to fund the loan portfolio. Institutions will have to reach out to a more diverse client base to attract net savers. As an institution achieves the sound financial management practices presented earlier in this chapter, it can market its ability to protect savings—or the image of safety—to prospective savers.

Improving the physical image of an institution can accelerate savings mobilization dramatically. Savings growth is highly correlated with the perceived soundness, professionalism, and attractiveness of an institution. An image of professionalism and security can improve public confidence in the institution and attract new clients. A mediocre physical image undermines public confidence in a financial institution. Improving the institutional image must be a top priority, as well as a key component of the marketing program.

Secure infrastructure requirements include locked drawers at teller stations, safes or vaults for holding cash, and grill or glass partitions between teller stations and the public. Grills and bars should be installed over doors, windows, and air conditioners. A trained guard should be present. Although secure in its structure, a savings institution must continue to present a pleasant, friendly, and inviting image. Marketers and managers must ask, is the institution sufficiently attractive to draw net savers? Does the image portray a sense of security? The photos in Figures 2.5 and 2.6 show the before and after images of a financial institution in Nicaragua that remodeled itself before mobilizing savings.

External infrastructure improvements in these institutions included painting and minor repairs, securing windows and doors, and

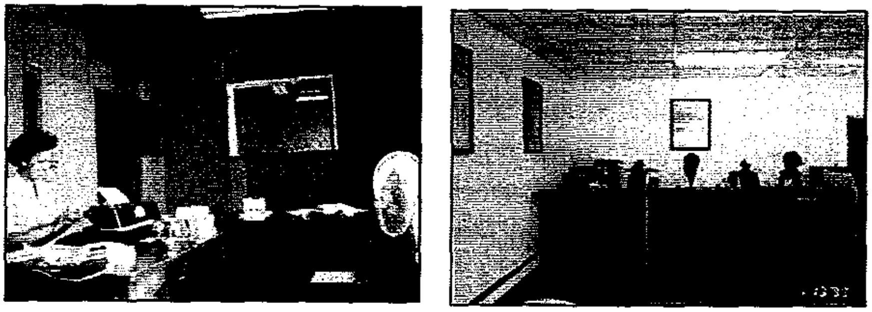
Figure 2.5 Improvements in the External Appearance of a Nicaraguan Credit Union



BEFORE

AFTER

Figure 2.6 Improvements in the Internal Appearance of a Nicaraguan Credit Union



BEFORE AFTER

creating billboards. Internal improvements included upgrading offices, teller windows, and reception areas.

Determining Feasibility

Before attempting to mobilize savings or directing resources toward expanding savings services, an institution's managers should determine the feasibility of offering these services in the local market. Market studies can identify the savings potential in a community, the growth potential, and the characteristics of competing savings services. Client and non-client surveys identify financial service demands, as well as perceptions of the institution in comparison to competing institutions. Feasibility studies enable an institution to:

- Define the market;
- Evaluate the competition;
- Analyze the existing service structure;
- Define a strategy for market penetration;
- Implement targeted marketing programs;
- Develop new products and financial services; and
- Promote savings programs.

Devising a Marketing Plan

Managers should develop a marketing plan for savings that sets clear goals and identifies specific strategies for accomplishing those goals. A plan might include:

GOAL: Increase clientele by x percent

- Produce and distribute brochures.
- Raffle small appliances to attract new clients.
- Offer fixed-term deposit of x-amount to the client who brings in the largest number of new clients.
- Promote the institution with the mayor and local community organizations.
- Sponsor community events.
- Sponsor a festival for the community at the end of the year.
- Arrange for the manager to be interviewed on radio and television.

GOAL: Mobilize growth in passbook savings by x percent

- Raffle valued appliances for new savings and high account balances.
- Increase interest rates on new deposits.

GOAL: Improve the physical image of facilities

- Paint the facility, repair all deterioration.
- Restructure the lobby, counters, and offices to maximize service.

The details of marketing plans will differ among institutions; however, all marketing plans should set out goals and provide specific steps for reaching them.

Once a savings institution has implemented the critical elements to mobilize savings, managers shift their attention to facilitate growth, through business planning.

Business Planning

Business planning is key to managing the growth of a savings institution. An effective business plan logically details how an institution can achieve its targets in client growth, capitalization, savings growth, loan and investment activity, and capitalization. The business plan becomes a key tool for managers to achieve policy reforms and financial goals. The plan specifies marketing activities, policy changes, and service adjustments to be made during the year.

The annual planning process focuses on balance sheet improvements and sets specific financial performance goals. The plan should include development of *pro forma* balance sheet and income projections. With these projections, detailed work plans can be created to map out how the savings institution will achieve its goals, put savings protection provisions in place, and change its financial structure as it increases savings. Business planning projects costs and tells managers how much income must be generated to cover financial costs and operating expenses. Managers should develop business plans annually to set new growth targets, budgets, and progress indicators.

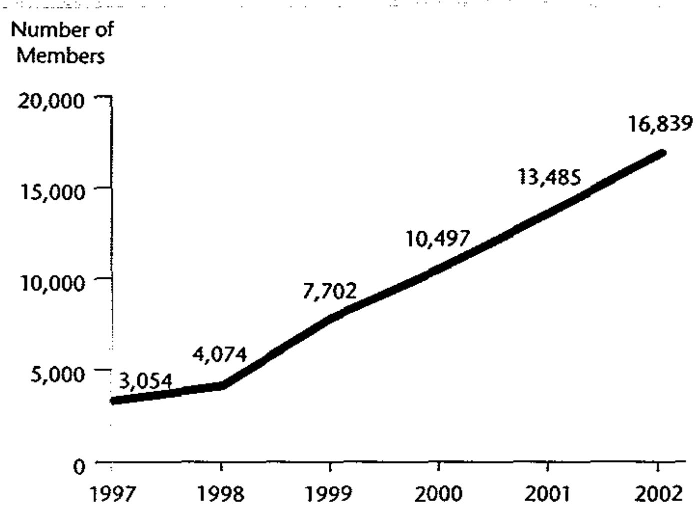
Managers and the board of directors supervise implementation of the business plan by comparing indicators against goals on a monthly basis. This supervision can be done quarterly as a savings institution becomes more experienced in plan implementation.

Conclusion

Mobilizing savings, particularly the savings of the poor, requires commitment and discipline. In offering savings products, an institution

Looking again at Nicaragua, Figure 2.7 shows that the volume of savings and the client base grew. Membership grew from 3,054 in 1997 to 16,839 in 2002. The growth was due to the increased public confidence in the credit unions and to the new services that these institutions could offer.

Figure 2.7 Growth in Membership in 14 Nicaraguan Credit Unions



takes on the responsibility of protecting the deposits of savers. If it does not put the critical elements of financial management in place, the institution puts the deposits of savers at risk. This can be particularly damaging to the poor.

Most of the critical elements laid out in this chapter are implemented and achieved through the process of savings mobilization. The seven minimum preconditions that an institution must have in place *before* mobilizing savings are: legal authority, use of an up-to-date accounting system, accounting books that are closed monthly, full provisions for all loans delinquent more than 12 months or where the term is past due, use of a delinquency tracking tool, liquidity reserve of 10 percent of total deposits, and internal control policies and procedures. If an institution meets these preconditions from the outset, it should be able to protect the value of deposits, while working toward achieving the other critical elements of savings mobilization.

An institution must be in an enabling environment to launch and maintain a successful savings mobilization program. Three key environmental elements are: manageable inflation, legal authority, and effective supervision. Relative macroeconomic and political stability are also necessary for financial intermediation to be successful.

At the institution level, an effective governance structure must exist in order to control conflicts of interest and to manage the institution within a prudential framework. A transparent accounting nomenclature and reporting system, which follows generally accepted accounting principles, promotes accuracy and increases efficiency. Accurate and transparent accounting records are prerequisites to using a monitoring system that tracks financial performance. Formalized policies and procedures set the foundation for quality financial management.

Sound financial management enables institutions to raise deposits from savers and use the deposits to finance growing loan portfolios. Credit and collection management tools are necessary to maintain quality loan portfolios and reduce the level of risk to savers. High levels of delinquency can quickly erode the value of the savings deposited in an institution. Three lines of defense protect the value of deposits: provisions, institutional capital, and paid-in shares. Cash flow analysis, liquidity management, and asset-liability management are essential to managing savings and loans.

Institutions must implement monitoring systems to track financial performance. The PEARLS financial performance monitoring system is a quantitative system that enables managers to monitor protection, effective financial structure, asset quality, rates of return and cost, liquidity, and signs of growth. ACCION's CAMEL model is another monitoring system option for MFIs. When an institution has a system in place to monitor current and past performance, managers and the board are better equipped to plan for the future.

Assessing and increasing the capacity of an institution's human resources is important in starting savings programs. In many cases, institutions will need to increase their staffing levels to handle the increase in clients and transactions. Savings mobilization will require a reorientation of all staff in formerly credit-only institutions. Staff will need training in customer service, cash management, marketing, interest rate management, and liquidity management.

Savings growth is highly correlated with the perceived soundness, professionalism, and attractiveness of an institution. Before engaging in savings mobilization, managers should ask themselves whether their institution projects an image of safety and soundness. Secure physical infrastructure can create the image of security that savers seek. As the client base grows and demands for service increase, the institution must adapt to the changing environment and provide convenient services to savers.

Managers should determine the feasibility of offering savings services in the local market before implementing or expanding a program. Market studies identify savings potential, growth potential, and competing services. A marketing plan sets out goals and identifies specific strategies for achieving those goals. Business planning is an important tool for managers and the board of directors to use in charting the course to safety, soundness, and growth.

This chapter provided the basic information that managers need (1) to assess whether their own institutions are ready to mobilize savings responsibly and (2) to prepare their institutions to mobilize savings successfully. Readers are encouraged to consult other resources, such as accounting manuals, credit guides, or financial management texts, for more detailed information on the critical elements for safe and sound savings mobilization.

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CHAPTER 3 Savings Product Management: Establishing the Framework

Brian Branch

Savings mobilization is a demand-driven activity. Any savings institution, whether a bank, credit union, or other type of microfinance institution (MFI), must offer savings products that meet the demands of existing and potential clients. A savings institution asks savers to place their funds within its care taking and then uses those funds to finance its loan portfolio. This relationship reverses the traditional power dynamic between clients and MFIs in which borrowers approach the institutions to ask for loans. In this new dynamic, a savings institution must market and sell itself to clients; it must convince savers that their savings will be safe and well managed.

Through surveys of savers in various regions of the world, WOCCU has discovered a common pattern in what savers look for in a place to deposit their savings. First, savers most frequently report that the key feature they seek is safety. A savings institution will be successful only if it can demonstrate to clients that it is safe and secure. Secondly, savers look for convenience: access and liquidity. They want to be able to access their funds whenever they need or desire them. Thirdly, savers look for a positive return on their savings. Savers place priority in this order: safety, convenience, and return.

These priorities shape the way we develop savings programs and tailor savings products to meet client demands. Building a safe and sound savings institution involves establishing sound financial disciplines that will protect the value of savings. The effective design and management of savings products provides savers the convenience and return they seek.

Once a savings institution designs products to meet the local demand, it must effectively manage those products. Savings policies define the products offered and outline the procedures by which their liquidity, pricing, and transactions are managed. Savings policies should be updated regularly in response to market demand in order for products to remain competitive in the marketplace.

Interest rates determine the returns savers will receive on their deposits. To mobilize savings on a large scale, savings institutions must offer attractive rates. When setting interest rates, savings institutions should pursue three general principles: (1) market-driven, competitive rates; (2) cost-based rate setting; and (3) real return on savings. In addition to these principles, institutions should also consider the core characteristics of each product, together with the associated transaction costs, so that savings products are cost-effective for the institution, as well as gainful for the saver.

For institutions that have not offered savings services previously, the introduction of a savings program presents a new set of risks. Savings institutions should establish policies and procedures for liquidity management, cash management, and implementation of internal controls to address the new risks.

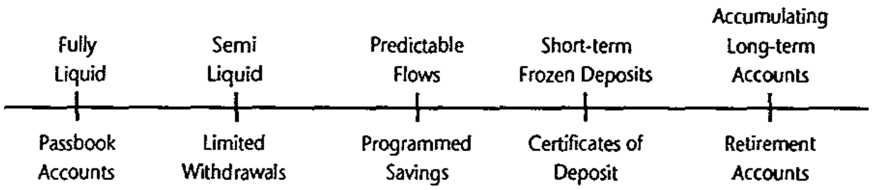
Savings Products

Savings products are built in three ways. Products are designed to balance the trade-off between liquidity (access) and return (compensation). Savings products are tailored to respond to the demands of particular market niches; for example, farmers who save in large amounts after a harvest and withdraw savings gradually through the year, or youth who save in small amounts due to limited incomes. Products are adapted to the purposes for which clients save; for example, to pay education fees or to purchase large expense items such as appliances or homes. In any case, products should be designed to satisfy local client demands for savings services.

Liquidity Versus Returns

Savings products exist along a continuum of trade-offs between liquidity (access) and return (compensation). Some products offer complete access to deposits (withdrawals whenever the saver wishes) with relatively low returns. Other products restrict liquidity (withdrawals), but offer higher returns. For instance, fixed deposits are not withdrawable for a stated period of time, but offer higher interest rates than the liquid passbook accounts. A mix of products offers options of fully liquid, semi-liquid, fixed short-term, and accumulating long-term accounts, as shown in Figure 3.1. A range of product offerings should serve to satisfy the convenience and return demands of savers.

Figure 3.1 A Mix of Products Offers Alternatives



Small and low-income savers often seek small accounts that offer high levels of liquidity. These savers exhibit strong preferences for products such as passbook accounts, or demand savings, with low minimum balances and immediate access to savings at all times. These small and low-income savers are willing to sacrifice return for open access to their funds. Smaller savers may graduate from low-balance, low-return products to larger, higher-return products as their income and assets grow.

Alternatively, larger and wealthier savers seek to maximize their returns on savings and are willing to sacrifice access for higher returns. Larger savers often prefer products such as fixed-term certificates of deposit and long-term retirement accounts, which provide higher returns. Many of these savers prefer to build illiquid longer-term savings in pursuit of future goals while maintaining a minimum amount in a liquid passbook account for immediate or emergency needs.

Tailored Savings Products

A savings institution may offer a combination of generic savings products for the market at large and tailored savings products to address the particular demands of an identified niche. For example, youth accounts are designed to combine low returns and limited liquidity with small balances to serve the limited-income market segment under the age of formal client status (usually 18 years of age). At the other end of the continuum, savings products developed for businesses and institutions are usually large-balance time deposits that combine high returns and restricted liquidity. If savers have medium- or long-term plans to finance large personal investments such as education or housing, programmed savings accounts with set terms, moderate returns, and limited liquidity can help them to achieve their goals. A savings institution must identify the particular demands of the local market in order to design the right mix of marketable savings products.

Product Development

When developing products, savings institutions first conduct market studies to identify local client preferences and evaluate local competitive conditions. Market studies provide two types of information: (1) client profiles and preferences, and (2) intelligence about services and product characteristics that competitors offer. Both types of information are key to tailoring savings services to meet the local demand.

To reach a diverse clientele and attract net savers, savings institutions must first identify who the savers are in a community. Market studies examine local demographic and economic characteristics to help managers define a strategy to penetrate the market. *Quantitative* research provides data from secondary information sources such as census and databases. *Qualitative* data is gathered from primary sources such as focus groups and member surveys (discussed in Chapter 4).

Market studies enable managers to identify competing savings institutions and evaluate the quality of their services. Savings institutions can design attractive products by comparing the service characteristics—price, interest rate scale, term, minimum amount, convenience, waiting period, service variety, sophistication of product—with those of other local savings institutions and then improving those service characteristics.

Presentation of Products

Product design must be simple and clear, so that clients can choose products with the confidence that they understand all the benefits and costs. Simplicity also helps reduce administrative procedures and contain operating costs. Some credit unions offer a limited range of savings products, while others offer a highly differentiated, wide range of products. The extent of variation generally depends on the size of the market served and the variety of demands in that market. Products should not be designed to compete with each other, but to meet specific niche demands of clients.

Successful savings products most often have attractive and memorable names. Frequently, positive adjectives are added to the account names, such as platinum, gold, or silver. In this example, the higher the value of the metal, the higher the interest paid on the named account. And the higher the interest paid, the higher the minimum balance requirement. Product names may also be related to the market niches to which they are targeted; for example, "Home Savings" or "Education Accounts."

The credit union experience in mobilizing voluntary savings has focused primarily on six savings products: passbook accounts, fixed-term certificates of deposit, youth savings, programmed savings, institutional accounts, and retirement accounts. Table 3.1 shows the core characteristics of these products, defined as: target market, interest rate, minimum opening deposit, minimum balance requirement, withdrawal policy, promotion, and institutional implications.

Some basic product types are described here, with interest rates and pricing mechanisms, withdrawal policies, relationships to lending, promotional requirements, and advantages and disadvantages for both clients and savings institutions. Examples of real products demonstrate the impact of effective product design.

Passbook Savings Accounts

The passbook account is the most popular savings product in credit unions. The characteristics that make the passbook account attractive to a wide market are its complete liquidity, easy accessibility, minimum amount to open, no or low minimum balance requirement, and competitive rate of return. Clients can deposit money and withdraw it as they wish. This product is aimed at micro and small savers who demand high liquidity. It also serves larger savers who maintain a portion of their funds in these liquid accounts for withdrawal on demand.

Pricing. Interest rates on passbook accounts should be market-based, competitive with other financial institutions, and provide positive real returns above inflation. The savings institution should offer an interest rate up front, with the rate remaining variable so that it can be adjusted up or down as market conditions warrant. Many credit unions tier their interest rates on passbook accounts according to account balances. In order to encourage savings growth and to compensate for the higher percentage transaction costs on small accounts, credit unions pay higher interest on accounts with larger balances.

Table 3.1 Savings Product Characteristics

Product	Target Market	Interest Rate	Minimum Opening Deposit
Passbook Accounts	Primarily micro and small savers, large savers for on-demand use of some funds	X (base rate), rate increases with increasing account balance	None or very low
Fixed-term Certificates of Deposit	Net savers who seek to maximize returns	X + 2%, fixed at opening of certificate, higher for longer term or larger balance	High
Youth Savings	Population under the legal age of client status (usually 18 years of age)	X – 1%, paid only on accounts with balances above certain threshold	None or very low
Programmed Savings	Clients with specific goals or set targets, examples are Christmas clubs and education or housing accounts	X + 1%, higher than passbook and lower than certificates of deposit	Higher than passbook
Institutional Accounts	Organizations such as NGOs, churches, foundations, associations or corporations that require servicing of funds	X + 2%, increases with balance	Highest
Retirement Accounts	Net savers who seek to maximize returns for long-term planning	X + 2%, tied by contract to real return above inflation	High

Minimum Balance Requirement	Withdrawal Policy	Promotion	Institutional Implications
None or very low	Unlimited, or completely liquid	Brochures, flyers, lobby signs, lotteries, prizes, and advertising	Most popular product. Provides abundant and low-cost source of funds. Higher transaction costs when balances are low or withdrawals are frequent.
Set at opening of account	Term stated at opening of account, only upon reaching maturity, minimum 30 days	Brochures, flyers, lobby signs, and lotteries	Low administrative costs. Stable funds to finance longer term loans or investments. Facilitates cash and liquidity management.
None or very low	Unlimited, or completely liquid	School outreach, brochures, flyers, lobby signs, and targeted gifts or promotional items	Establish early client relationships, attract parents of youth to become clients. High transaction costs and low consolidated volume.
Accumulates with consecutive deposits	Specified at opening of account, only at end of planned savings period, penalty assessed if withdrawn early	Brochures, flyers, and lobby signs	Provides easily managed, predictable liquidity flows. Low administrative costs with only one withdrawal.
Highest	Unlimited, or completely liquid	Visits to institutions	Provides access to larger savings collected by institutions or groups. Very sensitive to interest rates, can create liquidity risk if constitute large portion of total deposits.
High, accumulates with consecutive deposits	Upon reaching retirement age, highly restricted	Brochures, flyers, lobby signs, and visits to target groups	Prior to offering services, institution must find out about applicable laws. Facilitate liquidity management due to restricted withdrawals.

Passbook accounts in Ecuador. The passbook product serves a wide market, but is particularly attractive to micro and small savers who demand high liquidity. Credit unions in Ecuador offer savings services to a large number of savers with small accounts. The savings account distribution in Table 3.2 shows low average and median savings account sizes. The average passbook deposit size in these 22 Ecuadorian credit unions was $77. The median account size was $61; in other words, half of all savings accounts were less than $61. Women held 43 percent of the accounts, comprising 37 percent of the total savings volume.

Table 3.2 Passbook Savings Account Profiles in 22 Ecuadorian Credit Unions[1]

	Men	Women	Total
Total Volume	37,984,825	21,865,727	59,850,552
Number of Accounts	446,281	335,351	781,632
Average Account Size	85	65	77
Median Account Size	68	52	61

All numbers are rounded to nearest whole, in U.S. dollars.
[1]*As of March 2001.*

Table 3.3 shows the distribution of passbook accounts by size. The Ecuadorian credit unions displayed a pattern consistent with more mature credit unions: many small accounts that are held by low-income members, a small number of large accounts over which to spread fixed costs, and a moderate number of mid-range accounts that provide a stable base of funds.

The majority of passbook accounts—81 percent—had less than $100. These small accounts provided only 19 percent of the total savings volume. The credit unions serviced another 100,000 accounts with balances between $101 and $300; thus, 94 percent of all accounts held less than $300. This 94 percent of accounts represented 41 percent of the total savings volume in the credit unions.

The 6 percent of accounts with balances greater than $301 accounted for 59 percent of the total savings volume. The few large accounts offset the fixed costs of the savings services, reducing the fixed costs per dollar deposited, and fund much of the loan portfolio for low- and middle-income borrowers of the credit unions.

Table 3.3 Passbook Account Size Distribution in 22 Ecuadorian Credit Unions[1]

Account Size in U.S. $	Volume	%	Accounts	%
1 – 100	11,387,591	19	634,817	81
101 – 300	12,899,450	22	101,027	13
301 – 500	7,995,400	13	20,810	3
501 – 1,000	9,542,151	16	15,244	2
1,001 +	18,025,960	30	9,734	1
Total	**59,850,552**	**100**	**781,632**	**100**

All numbers are rounded to nearest whole, in U.S. dollars.
[1]As of March 2001.

Some credit unions establish a minimum passbook balance before interest can accrue. Accounts below the minimum balance do not earn interest. This allows an institution to offset the maintenance costs of smaller accounts, where transaction costs are high relative to the balance of the account. At the same time, it offers the smallest savers a store of value for their savings as well as the opportunity to build their accounts over time from small amounts to larger ones that do earn interest.

Withdrawal policy. As fully liquid products, passbook accounts generally allow unlimited withdrawals. Some credit unions have experimented with semi-liquid variations of passbook accounts that limit the number of withdrawals per month or charge fees for withdrawals over a certain number. Such limited passbook accounts have proven to be less popular than basic passbook products; savers consistently prefer unlimited withdrawals on passbook savings.

Relationship to lending. Passbook accounts respond to market demand for savings for the sake of saving. There is no leveraging relationship to lending. The amount in a passbook savings account provides little information on an individual's income earning capacity or debt repayment capacity.

Promotions. Credit unions offer savers incentives to increase deposits by tiering interest rate structures to offer higher interest rates for larger balances and by holding lotteries for benefits or prizes. Interest rate premiums on new accounts serve to attract new savers to an institution.

Lotteries. Credit unions have found that the lottery of benefits or prizes, with the associated publicity, provides significant incentives for small savers. Lottery prizes may include food, household items, bicycles, motorcycles, or even sums of money. A savings institution can hold lotteries periodically to maintain incentives for both small and large savers. For example, *Union Popular* in Guatemala holds one lottery every three months to award small prizes to smaller deposit holders and another lottery every six months to award larger prizes to the larger depositors. In all cases, the rules for all lotteries should be clearly defined and publicly available.

Lotteries can serve the dual purposes of increasing the size of deposits from existing clients and attracting new deposits from new clients. The most effective lotteries provide incentives not only for increasing account balances, but also for maintaining them. If savers must have a minimum balance to participate, they are likely to maintain higher account balances over the long term. When savers deposit into their accounts, they receive lottery entries based on the amount

Limited withdrawals in Mexico. In one instance, a *caja popular* experimented with passbook accounts that permitted withdrawals only on certain days of the month and limited the number of withdrawals allowed each month. The accounts were designed to facilitate the credit union cash flow needs, but were inconvenient for members and unpopular as a result. They never accounted for more than one percent of the *caja's* total savings volume.

deposited. When they withdraw from their accounts, they disqualify themselves from the lottery for that period.

Lotteries do incur some costs to the savings institution. Administrative costs include the costs of the prize and the costs for publicity and printed materials (tickets and posters). As the savings pool competing for the prizes grows, however, the costs as a percentage of the savings mobilized through the promotion falls. The costs are usually more than offset, since the provision of a prize allows the savings institution to offer lower interest rates and incur lower financial costs on the accounts included in the lottery. With one-time or temporary campaigns, savings institutions must be sure to have enough liquidity available to pay out any savings withdrawn after the close of the promotion.

Interest rate premiums. Another way to increase savings mobilization is to offer interest rate premiums to new savers. The savings institution announces, through public notices and posters on the walls or in the windows, that an additional fraction of a percent—on top of the normal rate—will be paid on new passbook accounts or fixed-term certificates of deposit opened during a certain period of time. This increase in the rate creates a financial incentive for non-saver clients and unaffiliated members of the community to deposit their savings in the institution.

Offering interest rate premiums is a fast and efficient way to attract new resources and stimulate savings growth. Premiums incur much lower administrative costs than lotteries. Rate-based promotions have proven to attract deposits rapidly, but they also risk prompting savers to withdraw existing deposits that earn lower rates in order to deposit them at expected higher rates during future promotions. Premiums may also create an expectation that rates will always be high; rules and rates of the premium must be well publicized.

Advantages and disadvantages. The advantages of the passbook account for the client are twofold: it provides easy access for withdrawals, and it offers a market return on savings.

For the savings institution, the passbook savings product can be an abundant and low-cost source of funds. It is also the master account that supports other financial services and products. For instance, passbook accounts can serve as the crediting accounts for loan disbursements, as the receiving accounts for wire transfers, or for the liquidation of fixed-term certificates of deposit when they mature.

The drawbacks of this account for a savings institution are: high transaction costs when the balances are low or when withdrawals are frequent, high operating costs to administer transactions and calculate interest in non-computerized institutions, and volatility of deposits and withdrawals. These factors can complicate daily and weekly cash flow management and therefore command disciplined savings management.

Fixed-term Certificates of Deposit

The fixed-term certificate of deposit is the second most popular savings product in credit unions. A certificate of deposit is a signed contract between a financial institution and a client. The contract specifies a certain amount to be deposited, until a stated maturity, for a set interest rate.

Fixed-term savings products are targeted to the market niche with greater savings capacity. They are designed for net savers who seek to maximize returns on their savings and are willing to sacrifice liquidity to do so. The primary users of these accounts tend to be people who have accumulated some stock of savings or wealth. The market for fixed-term products often includes associations or firms that want to realize higher returns on large volumes of funds. This market may also include individuals who want to save for long-term goals such as home building, land purchase, or education.

Fixed-term accounts offer limited liquidity, but provide higher returns than more liquid products such as passbook accounts. Larger minimum balances are required for fixed-term deposits. A certificate of deposit contract bears the saver's name and signature and the institution's identifying marks. The contract is non-transferable and non-negotiable. The fixed-term deposit can have either discretional or automatic renewal upon maturity, according to the terms agreed upon when opening the account.

Credit unions often start by offering fixed-term deposits with 30- and 60-day maturities, adjusting or expanding the offerings according to member demand. An institution's fixed-term offerings might include: 30 days, 60 days, 90 days, 120 days, 180 days, one year, two years, and three years. These deposits should be matched to loan products of comparable terms so savings institutions can maximize earnings while maintaining sufficient liquidity.

Pricing. The interest rate is set when the certificate of deposit is signed. The interest is paid upon maturity for all fixed-term products. To compensate the saver for sacrificing liquidity, these accounts offer higher rates of return than other products. Fixed-term products, or certificates of deposit, are usually the most costly for the savings institution in terms of the rate of return paid. The longer the term of the certificate, the higher the interest rate paid.

Fixed-term funds tend to be interest rate sensitive. As fixed-term deposits come to maturity, clients will renew the certificates or move them elsewhere, according to where they find the best returns.

Withdrawal policy. As a general rule, fixed-term deposits may not be withdrawn until the date of maturity. In some cases, however, the early withdrawal of some or all funds may be approved, but the client pays a penalty for early withdrawal.

Relationship to lending. Clients may use fixed-term deposits to secure loans. (Note: this is a security relationship and not a leveraging relationship.) The loan term should match the deposit maturity. Deposits used to secure a loan may not be withdrawn while the loan is outstanding.

Promotion. Posters and brochures that display the rates of return paid on the certificates of varying terms are the most effective means to promote the product. The posters and brochures should be displayed prominently in the lobby and at the teller counters of the savings institution.

Advantages and disadvantages. For the client, fixed-term certificates of deposit offer higher interest rates than other savings products. Fixed-term savings can also serve as security for loans.

The primary advantages of fixed-term products for a savings institution are in cash flow and liquidity management. Since both the price and the term of the product are fixed through a contract at the outset, the savings institution can use the funds in fixed-term accounts to finance longer-term loans or investments. Fixed-term products have lower administrative costs, with only one initial deposit transaction and one withdrawal transaction upon maturity. Fixed-term accounts typically provide a large portion of the savings mobilized by credit unions.

The higher financial cost of funds from fixed-term accounts is the primary disadvantage for the savings institution. Another drawback is that there is no guarantee of renewal upon maturity of the term, as renewal decisions are sensitive to interest rates.

Programmed Savings Accounts

Savings products that are tailored to assist savers in the achievement of certain goals or set targets are popular in credit unions. Programmed savings are accounts in which deposits are made on a regular basis for specific purposes and time periods. For example, a regular deposit is made into the account each month for 11 months. On the 12th month, the client withdraws the full amount of the savings plus the interest accrued during the specified period. In other cases, regular deposits may be made on a daily or weekly basis.

Programmed savings typically include:

- Christmas clubs and vacation accounts, which usually have one year terms.
- Education accounts for families who save for cyclical school fees on a six- to 12-month basis.
- Housing accounts in which clients save a fixed amount each month for periods of one to three years to use as down payments and to qualify for loans for the purchase of a home or land.

Pricing. Programmed accounts pay higher returns than passbook accounts to provide clients with added incentives to make scheduled deposits. The higher interest rates compensate clients for the restricted liquidity.

Withdrawal policy. The client may not make withdrawals from a programmed account until the specified maturity date. If clients withdraw funds before the maturity date, they must pay fines or penalties of no interest on the amount withdrawn, for each withdrawal.

Relationship to lending. Programmed savings deposits may be used as collateral to secure loans. (Note: this is a security relationship and not a leveraging relationship.) Account withdrawals are frozen when programmed deposits serve as security for a loan, even when clients reach the maturity date of the program.

Promotion. Posters and brochures that outline the characteristics of the programmed savings accounts offered should be displayed prominently in the lobby and at teller counters.

Sample housing product. Housing finance is a high priority for many low-income savers and client families of savings institutions. Housing finance requires significant down payments and larger loan amounts. In response to this, many credit unions provide a product that enables members to save in order to accumulate capital for down payments and qualify for loans to meet their housing needs.

The Housing Savings Product has the following characteristics.

- A term of one to three years with required monthly deposits of a fixed amount.
- Upon reaching the period end and fulfilling the terms of the program, the client may withdraw his or her savings, including the interest received, renew it, or roll it over into a fixed-term certificate of deposit.
- Upon fulfillment of the program schedule, the client may qualify for a preferential housing loan up to a specified amount, for a specified term, at a special interest rate.
- If a client does not deposit during one, or even a few months, the funds are not affected, and interest continues to accrue on the accumulated total. This may be sustained for up to three months, after which time the contract would undergo liquidation at a lower interest rate than the institution pays on savings deposits.
- No withdrawals are allowed until the end of the period.
- If a client does withdraw funds before the end date, he or she must pay a fine or penalty of no interest on the amount withdrawn, for each withdrawal.

Advantages and disadvantages. The principal advantage of programmed savings for clients is that it provides them with a structure to save toward a specific goal. Programmed accounts offer savings alternatives to taking out loans in order to accomplish these goals. Programmed accounts also provide higher returns to clients than passbook accounts.

For the savings institution, programmed savings provide regular cash inflows that facilitate liquidity management. Fixed monthly savings installments are deposited in stable and predictable amounts, for known periods of time. A savings institution can be reasonably confident that the funds will come in or exit at a specified time. Programmed savings serve to soften market cycles. Furthermore, the product has low administrative costs, since deposits are scheduled and only one withdrawal is permitted at maturity.

Programmed savings do carry risks for the savings institution. For most programmed accounts, there is no assurance that the saver will comply with scheduled deposits, or continue to pursue the end goal and fulfill the terms of the contract. At the end of the program period, there is no guarantee the client will continue with the savings program. To mitigate renewal risk, a savings institution must manage these funds under the assumption that the program will not be renewed.

Youth Savings

The infant, children, and student savings accounts that comprise youth savings programs serve the market segment under the legal age

Retirement accounts. Retirement accounts are very long-term programmed savings accounts. They are usually offered as long-term savings accounts with regular deposits but no or highly restricted withdrawals. The rate of return is tied by contract to a real return above the inflation rate. Prior to offering these accounts, a savings institution must find out if there are any laws within the country that regulate retirement accounts. For the savings institution, retirement accounts can facilitate liquidity management since they hold longer terms than traditional fixed-term savings and often operate as semi-liquid funds with restrictions on withdrawals.

of adulthood (usually 18 years of age). Through youth savings programs, a savings institution can establish early client relationships with the young people in the local market, develop the future loyalty of young savers, and attract the parents of youth savers to become clients. The minimum balance required to open a youth savings account is usually lower than other accounts, to address the low savings potential of this market.

Pricing. Youth savings accounts operate like passbook accounts; they are fully liquid and offer variable market rates of return. Because youth savings is characterized by small amounts, this product has high relative transaction costs. The cost of administering a deposit or withdrawal is high relative to the size of the account. For that reason, the interest rate offered on youth savings is usually lower than that offered on passbook accounts. The balance required to earn interest tends to be higher for youth accounts.

Relationship to lending. Youth accounts have no relationship to lending since infants, children, and students are not eligible for loans.

Promotion. Targeted promotional items, such as piggy banks, stuffed animals, or school supplies, are often given out to provide incentives for the young to open savings accounts. Outreach in local schools is an effective way to promote youth accounts.

Advantages and disadvantages. For the savings institution, youth savings offers an attractive and highly visible service for markets with large concentrations of infants, children, and students. Youth accounts provide a less volatile source of funds with lower financial costs than passbook savings accounts.

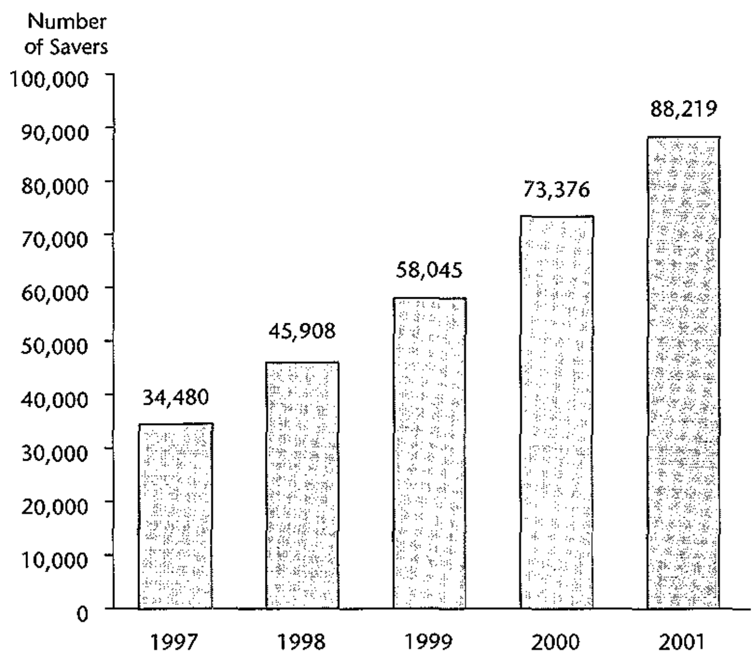
The disadvantages of offering youth accounts are the high transaction costs associated with handling the small accounts, the low volume of savings, and the high levels of direct marketing required to educate and attract youth savers. Youth savings are expensive to administer, but many credit unions offer the product as part of their marketing efforts. They hope to build youth loyalty, as well as attract the parents to use other financial services.

Institutional Savings

Savings institutions can offer institutional accounts to neighborhood associations, churches, corporations, other associations, unions, foundations, and non-governmental organizations (NGOs): organizations that require safe, convenient servicing of institutional funds. The terms and conditions will be the same for organizations as they are for indi-

Youth savings in Guatemala. After conducting market research and identifying unmet demand, Guatemalan credit unions introduced youth savings. They launched a full-fledged marketing campaign for children and adolescent savers in 1996. As of December 31, 2001, youth savers made up 21.7 percent of the 406,074 member-clients and accounted for 0.6 percent of the total savings volume. Figure 3.2 shows the growth in the number of youth savers since the campaign began.

Figure 3.2 Growth in Youth Savers in Guatemalan Credit Unions[1]



[1]*As of December 31, 2001.*

vidual clients. Since institutional savings accounts tend to have higher levels of activity than personal accounts and the transaction costs are greater, minimum balance requirements are higher and fees may be charged for account maintenance.

Advantages and disadvantages. Institutional products can enable the savings institution to access the larger volume of savings available from organizations. Savings institutions may also gain access to the members of the organization for the purpose of marketing individual savings services.

Institutional savings are often sensitive to interest rates and can be volatile. These large deposits can create liquidity problems for the savings institution if they constitute a large portion of total funds and the organization removes the funds abruptly. Sufficient liquidity reserves and investment in short-term liquid assets are required to manage the risks associated with institutional savings.

Shares and "Social Capital"

In addition to offering voluntary savings products, most credit unions require members to purchase obligatory shares (or equity paid-in capital). In some credit unions, the member shares are withdrawable upon the departure of a member. In others, member shares are non-withdrawable investments.

Note that where shares are withdrawable, they do not meet the definition of permanent or institutional capital. They are a liability, not capital. Where shares are included in net worth calculations, withdrawal is restricted if total credit union shares decrease by a specific percentage (for example, 10 percent or to a minimum net worth requirement). Shares counted as non-withdrawable capital or as withdrawable net worth must be free of encumbrances and cannot be used to guarantee loans.

Dividends paid on shares are based on available earnings and paid at the end of the accounting period each year (when the books are closed). No dividends should be paid on shares until the capital reserves-to-assets ratio reaches minimum standards; that is, 8 percent of total assets. To provide members with a return for their risk participation in the credit union, the rate of return on these shares should be higher than the returns paid on savings accounts. Management may advertise an anticipated rate to be paid on these accounts based on the rate that was paid at the end of past accounting periods. Credit unions should provision funds quarterly to pay the projected dividend to be paid on shares at year-end.

Account Procedures

Procedures for managing savings accounts include opening accounts, making deposits and withdrawals, and closing accounts.

Opening Accounts

To open a savings account, a client fills out an identification card that records his or her name, address, and signature. The identification card is completed only when the first savings account is opened, not for additional accounts. The client must sign the card in the presence of an official representative of the savings institution to ensure that a valid signature is obtained. The card designates one or more beneficiaries for the account in the case of death of the saver. To verify the new client's identity, a staff member photocopies a photo identification card, such as a driver's license or other government-issued identification card. The mother's maiden name is recorded and later used for individual verification. The identification cards should be stored in fireproof boxes that are locked when the institution is closed.

A client may open a passbook savings account with a minimum deposit. At this point, the client will receive an account number. Account numbers are issued in consecutive order beginning with 1. The numbers are permanent and non-transferable. A client may have more than one savings account. Each additional account should have the same number with a different suffix (255-1, 255-2, 255-3).

In the case of youth clients, the adult who is responsible for the minor must fill out and sign the identification card. Minors may make deposits and use funds as allowed by law. Upon reaching 18 years of age, a youth client may fill out an adult application. With the authorization of a relative, he or she may close the youth account and transfer the balance to another type of savings account.

Passbooks. If the savings institution is manual, or without computerized systems, the client presents a passbook that is updated as a record of transaction. A sample passbook page is shown in Figure 3.3. Even in many computerized credit unions, passbooks are still provided to members who want to hold their own records of their accounts or where mail delivery systems are unreliable. A teller or savings promotion employee opens a savings passbook in which all future activity will be registered: deposits, withdrawals, and capitalization of interest. In credit unions, dividends earned on shares are also recorded in the passbook. The balance must be brought up to date with each transaction. A teller or other staff member of the savings institution records transactions and balance adjustments in client passbooks.

The same procedures should be used to open passbook, programmed, youth, and institutional accounts.

If the current savings deposit accounts portfolio is managed with an automated computer program, passbooks are not issued and instead savers receive account statements in the mail each month, within ten days of the close. When clients make transactions, whether deposits or withdrawals, they receive copies of the deposit or withdrawal slips. The evidence in a computerized system is the receipt generated after each transaction, together with the monthly statements.

Certificates of deposit. To open a fixed-term certificate of deposit, a client must fill out an application. The teller completes a deposit slip and the certificate of deposit with the name of the client, date and amount of deposit, interest rate, term, date of maturity, schedule, and method for payment of interest. The client should designate two or more beneficiaries as part of the process of opening a certificate. The teller sets up a suffix number for this account if the client has other existing accounts with the institution or provides a new account number if this is the client's first account. The certificate becomes a contract between the savings institution and the client.

Replacement of a passbook or certificate of deposit due to loss, destruction, or theft is the responsibility of the client. If a fee is associated with replacement, the client is responsible for paying the fee prior to receiving the new passbook or certificate. The new document will show the account balance kept by the institution, unless the client has convincing evidence of a different balance.

Procedures. Institutions must adopt clear and consistent procedures for the administration of savings accounts. The standardized text on forms used to open savings accounts might appear as:

Figure 3.3 Example of a Typical Passbook

LOGO

SAVINGS INSTITUTION
Address
Phone number

PASSBOOK ACCOUNT

Name: ____________________
Address: ____________________

Account Number: ____________________
Client Number: ____________________

DATE	DEPOSITED	WITHDRAWN	BALANCE	CASHIER

Note: Terms and conditions of the account are printed on the reverse side if the passbook is one page folded.

If the passbook is a small book, the logo, savings institution, and account holder name and account number are printed on the outside of the front cover and the terms and conditions of the account are printed on the inside front or back cover.

> The initial deposit to open this account is ______. The minimum savings deposit allowed thereafter is ______. The minimum balance of savings required in order to earn interest is ______. The maintaining balance is ______. The maximum allowable savings balance is ______. The minimum withdrawable amount is ______. On a monthly basis, the number of withdrawals allowed is ______. Withdrawals of less than ______ can be paid in cash. A withdrawal over that amount will be paid by check.

Fees. To help cover administrative costs, some credit unions charge fees or commissions to savers for opening accounts, issuing passbooks, making withdrawals, or maintaining accounts with low balances. Such fees must be limited so they do not have the effect of crowding out microsavers. In fact, most credit unions have eliminated these fees to minimize both transaction costs and barriers to entry for persons who want to join or save in the institution.

Deposits and Withdrawals

Over-the-counter deposits. Generally, cash or "over-the-counter" deposits are accepted with presentation of the appropriate passbook or identification. Upon presenting the sum for deposit, the client fills out a deposit slip and the teller updates the balance in the passbook. The updated passbook and a copy of the slip are given to the client as evidence of the deposit. If an institution does not issue passbooks, the client must retain all deposit slips and receipts as evidence of transactions.

Deposits may be accepted without presentation of the passbook if the client submits the required deposit slip. A third party may make deposits on behalf of an account holder as long as the required deposit slip is submitted with the deposit. In both cases, the passbook is updated at a later date. Clients are responsible for presenting passbooks or receipts as evidence in cases of error.

The teller should count all cash and put it in the drawer immediately after each transaction. No money should be left on the counter. In many countries, tellers are required by local regulation or money-laundering controls to notify managers if they receive a deposit above a certain amount.

If checks are accepted for deposits, accounts should not be credited until the savings institution determines that there are sufficient funds in the issuing account to cover the check. Interest is paid from the day the deposit is made until the date of withdrawal, even though the funds are not available for withdrawal until the check has cleared. Fees should be charged for returned checks.

A sample deposit slip is shown in Figure 3.4.

Direct deposits. Through cooperative agreements with employer institutions, credit unions often arrange to deduct directly from the payroll specific amounts authorized by employees for deposit into individual savings accounts. This provides a low-cost, stable inflow of funds for an institution.

Withdrawals. A saver is required to present identification when requesting a withdrawal. For each transaction, the client completes and signs a double-copy receipt. One copy stays with the savings institution; the other is given to the client as evidence of the transaction. A sample withdrawal slip is shown in Figure 3.5.

The teller registers the withdrawal in the passbook, recording the amount of withdrawal and updating the balance. The client receives a copy of the slip, the passbook, and the cash for the amount of the withdrawal. Withdrawals of funds can be made only by the account holder, by his or her legal representative, or by a person authorized through a signed order or power of attorney. Tellers should count cash three times before disbursing it to avoid counting errors.

The most convenient service would provide clients with cash for their withdrawals. However, when the withdrawal amount is too large for a small savings institution to administer safely, it becomes policy to disburse withdrawals above a certain threshold by check.

If an individual who is not the account holder tries to withdraw funds from a passbook and without written authority to do so, the savings institution does not permit the withdrawal and it confiscates the passbook. The institution should immediately inform the account holder of the withdrawal attempt and notify the authorities as necessary. The steps for making a withdrawal or deposit are presented in Figure 3.6.

Figure 3.4 Sample Deposit Slip

DEPOSIT SLIP

SAVINGS INSTITUTION

Deposits may not be available for immediate withdrawal

DATE	ACCOUNT NO.
NAME	
ADDRESS	

	CASH		OTHER	
	Dollars	Cents	Dollars	Cents
Deposits				
Personal Loans				
Real Estate Loans				
Interest				
Late Charges				
Vacation Club				
Christmas Club				
Insurance Fee				
Other				
Total				

Savings Balance $ ____________ Teller Initials

Loan Balance $ ____________ ______________

Checks Credited Only Subject To Collection

Figure 3.5 Sample Withdrawal Slip

WITHDRAWAL SLIP

SAVINGS INSTITUTION

DATE ACCOUNT NO.

NAME

MUST BE SIGNED BY CLIENT

Deposits	$	
Cash		
Checks		
TOTAL		

CLIENT SIGNATURE TELLER INITIALS

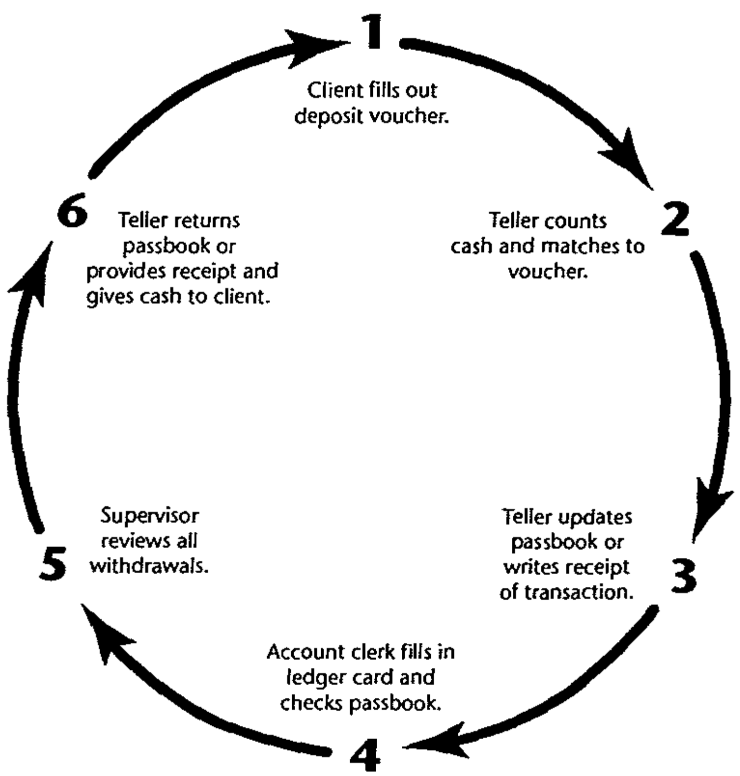
The general powers of credit unions allow them to place liens on member deposits as security, to freeze member deposits when loans are delinquent, and to write off unrecovered delinquent loans against delinquent borrower's or co-signer's savings deposits and paid-in shares.

Closing Accounts

Savers may close their savings accounts at any time, in accordance with the terms for each type of account. When closing an account, staff members in the savings institution must ensure that the deposit is not securing a loan. A savings account that secures an active loan may not be closed until the loan is repaid. If a client is delinquent on a loan, he or she may not withdraw funds or close the savings account.

When an account is closed, the signature card should be pulled from the active account file and placed in a closed account file. Every

Figure 3.6 Steps Required to Make a Withdrawal or Deposit



month, a list of closed accounts should be presented to management. The list should include account number, member name, and the reason for closing. The list should be kept as a permanent record.

For certificates of deposit, the client must indicate how he or she would like to receive the liquidation upon maturity. The client may receive the funds in cash, by check, in another savings account, through renewal of the certificate, or through a combination of these options. Fixed-term certificates of deposit closed prior to stated maturity are subject to a fee or penalty on the interest rate.

When a client dies, the savings institution must be given legal proof of death. When that document is received, the institution delivers the balance of any accounts held by that client to the named beneficiaries. If no beneficiary was named, the funds are delivered to the testamentary or legitimate heirs after the legal confirmation of the death of the client.

Insurance. Many credit unions provide life insurance on savings, which pays beneficiaries a benefit equal to the amount of savings that the deceased member had in the credit union (in addition to transferring the actual savings to the beneficiary). Where such insurance is offered, the legally identified beneficiaries receive any benefits related to the insurance protection.

Inactive accounts. A passbook savings account without activity of deposit or withdrawal for 12 months should be considered inactive. The client is sent a written notice to the address indicated on the identification card. After 18 months of inactivity, the savings institution sends a second letter to the account holder. After two years of inactivity, and if there has been no response to the letters, the savings institution closes the account and transfers the balance to non-distributable reserves or institutional capital.

Interest Rates

Surveys of credit union members in many countries drew consistent responses with regard to what members look for in savings institutions. After safety and convenience, savers seek returns on their savings (determined by interest rates). To achieve and maintain financial self-sufficiency, an institution must be able to pay competitive returns on savings deposits.

Given the wide range of alternatives (both financial and non-financial) available to savers, credit unions have learned that they cannot assume that members will deposit their funds with them out of institutional loyalty. Instead, savers want to invest their funds in the safest and most convenient alternative available, where they will receive the highest return on their savings. Where savings interest rates at credit unions are lower than those at other financial institutions, members have consistently taken their savings elsewhere, regardless of their affiliations.

Interest Rate Principles

In setting interest rates, savings institutions should pursue three general principles: market-driven, competitive rates, cost-based rate setting, and real return on savings.

Market-driven, competitive rates. To mobilize savings on a large scale, savings institutions must offer interest rates that are competitive with the rates offered in the local financial market. Managers should monitor competing savings institutions monthly to track the rates they offer on savings products and adjust interest rates as necessary to keep savings products competitive. Many credit unions pay one or two percentage points above their competitors. This may reflect an aggressive competitive effort. Or, it may reflect a higher return needed to where credit unions are not supervised by the Superintendent of Banks and do not enjoy the same level of public confidence as other formal financial sector institutions. Savings generally earn higher interest rates in urban centers where competition is stronger than in rural areas where savers have fewer alternatives.

Cost-based rate setting. Interest rates should be established through entrepreneurial planning. An institution's business plan should authorize rates that will cover operating costs and fund growth. Through business planning, managers can determine the interest rates to be paid on savings, and then set loan interest rates to cover the financial costs of savings products, the administrative costs of the institution, the provisions for non-collectible loans, and the necessary contributions to capital reserves. If market conditions require an increase in the interest rates offered on savings products beyond what is authorized in the business plan, managers will have to adjust the business plan to see if the increase is sustainable.

Real return on savings. The interest rates on deposits should be higher than the inflation rate to preserve the value of the deposits and provide a positive real return to savers. If this is not the case, the savings institution actually provides a disservice to savers, since their money loses value while deposited in the institution. Depositors have come to expect a positive real return on their savings. Small savers will often shift their savings to real goods, which can be resold without losing their value (a chicken or a calf in rural areas, tires or construction blocks in urban areas), if financial instrument returns are below the rate of inflation.

Pricing

Different products and levels of service incur different costs to the savings institution. Once an institution establishes interest rate policies based on the three principles above, it must attend to the operational management of rates. Interest rates will vary according to transaction costs, account balances, terms, withdrawal policies, and services provided.

It is the responsibility of managers to set the interest rate for each savings product. Managers must have the authority to quickly increase or decrease the rates paid on deposits so they keep pace with market trends and remain competitive. If the authority to set rates rests with the board of directors, the ability of an institution to respond to market conditions and remain competitive is compromised. The operating rules of an institution may authorize a range within which the manager may adjust interest rates without prior board approval.

Interest is paid on each account based on the periods stipulated by the savings policies. Variable interest is paid on passbook accounts, with the interest calculation based on the daily or average monthly balance. Accounts are credited monthly, or quarterly in some cases, with the corresponding amount of interest earned on the balance of current savings on deposit. Accounts are credited on the last day of the month. The 365-day calendar, and the corresponding monthly calendar, is used for the calculation of interest. When a client closes an account, interest is paid through the day prior to the closing.

Fixed interest rates are paid on fixed-term savings products. The savings institution pays the interest on fixed-term certificates of deposit in a lump sum upon maturity, together with the value of principal. The interest paid on fixed deposits is calculated based on the terms of the contract.

It is important that both the rates offered and the periods for calculation of returns are clear to all clients. They should be published and clearly visible in the lobby area.

Differentiation by balance. The administrative costs and transaction costs are a higher percentage of the value of smaller accounts than of larger accounts. Consequently, savings institutions offer higher interest rates on accounts with higher balances and lower interest rates on

Two Guatemalan credit unions, *Union Popular* in the rural coastal area and *Union Progresista Amatitlaneca (UPA)* in the metropolitan area of Guatemala City, increase the interest rate paid on savings as the amount in the account increases. Table 3.4 shows how rates rise with account balances.

Table 3.4 Comparison of Interest Rate Structures in Two Guatemalan Credit Unions[1]

Rural Credit Union: *Union Popular*

Account Size in U.S. $	Passbook Return %	Three Month Fixed-term Return %
3.50 – 17	4.0	–
18 – 175	8.0	9.0
176 – 877	8.5	9.5
878 – 1,754	9.0	10.0
1,755 – 8,772	11.0	12.0
8,773 – 17,544	12.0	13.0
17,545 +	13.0	14.0

Urban Credit Union: *UPA*

Account Size in U.S. $	Passbook Return %	Three Month Fixed-term Return %
4.40 – 351	8.0	8.5
352 – 1,754	9.0	10.0
1,755 – 3,509	10.0	12.0
3,510 – 13,158	11.0	13.0
13,159 – 43,860	11.5	14.0
43,861 – 70,175	12.5	14.5
70,176 +	13.0	15.0

[1] *Inflation = 8%.*

accounts with lower balances. The positive relationship between the interest rate and the account balance provides an incentive for savers to increase their balances, or not to withdraw their savings.

Minimum balances are established for each type of account, and the balance requirement is one variable in setting the interest rate for each product. Balances below a certain minimum are not paid interest to compensate for the higher relative administrative costs of small accounts. A client may begin saving by opening a very small account. The savings institution compensates for the high administrative costs for such an account by saving on interest costs. As the client saves more, the relative administrative costs of the account decrease and the savings institution begins to pay interest on the account.

A negotiated interest rate can be offered on larger individual or institutional accounts with high balances and limited withdrawals. The flexibility of negotiated rates enables the savings institution to attract deposits from market segments with larger savings capacities, where savers seek to maximize returns on large deposits. Such accounts tend to be extremely interest rate sensitive.

Differentiation by term. Interest rates on fixed-term certificates of deposit increase as both the account balance and the term of the certificate increase. Interest rates increase with the term length for fixed-term savings because the savers must be compensated for providing a stable source of funds for that term. In turn, the savings institution may invest those funds since they are not available for withdrawal. Table 3.5 provides an example of how rates differentiated by term might be structured.

Differentiation by product. A savings institution's costs vary according to a product's transaction costs, account balance, term, and withdrawal frequency; therefore, interest rate pricing is directly related to the variations in those characteristics. Lower interest rates are paid for those products with more administrative steps and more frequent transactions to cover the higher costs associated with those accounts. Products with restrictions on the availability of funds or on the number of withdrawals pay higher interest rates to compensate clients

Table 3.5 Average Nominal Interest Rates[1] on Fixed-term Certificates of Deposit According to Size and Term

Minimum Balance in U.S. $	Percent interest according to number of months					
	1-3	4-6	7-9	10-12	13-24	>24
200	8.88	9.88	10.63	11.88	12.75	12.75
500	8.88	9.88	10.63	11.88	12.75	12.75
1,000	9.00	10.00	10.88	12.00	12.75	12.75
2,000	9.13	10.13	11.00	12.13	12.75	12.75
5,000	9.25	10.38	11.25	12.38	12.88	12.88

[1] *Takes average rate on U.S. dollars and local cordobas.*

for the limited liquidity of their savings. Table 3.6 shows an example of interest rate differentiation by product.

The basic level interest rate is tied to the common passbook account. If we compare a typical interest rate structure according to varied savings services:

- Interest rates on withdrawable passbook accounts serve as the base rate (X) for the savings interest rate structure. The base rate is set according to competitive market rates, transaction costs, and the rate of inflation. The base rate is lower than most other rates because the passbook account offers low minimum balances and unlimited withdrawals. Clients accept a discount on their rate of return in exchange for complete access to their savings.
- Interest rates on youth savings accounts are slightly lower than the base rate (X-1) to compensate the savings institution for the higher administrative costs associated with very small accounts.
- Interest rates on programmed savings accounts may be a point higher than the base rate (X+1) to compensate savers for the limited liquidity.

Table 3.6 Sample Interest Rate Differentiation by Product

Type of Service	Interest Rate	Withdrawal Access	Account Balance	Minimum Deposit
Passbook Accounts	X (Base Rate)	Unlimited	Rate increases with increasing account balance	Low
Youth savings	X – 1	No Restriction	Uniform rate	Lowest
Programmed savings	X + 1	Only at end of planned savings period	Uniform rate with increasing balance	Higher than passbook
Fixed-term Certificates of Deposit	X + 2 (Increases with term)	Only upon reaching maturity	Rate increases with increasing account balance	High

- Interest rates on fixed-term certificates of deposit may be a couple of points higher than the base rate (X+2) to compensate savers for the limited liquidity.
- Dividend earnings on shares in credit unions should be higher than the rates paid on savings accounts to compensate and reward members for providing risk equity investment to the institution.

Penalties. Penalties are applied on interest returns when clients make early withdrawals from fixed-term deposits or programmed savings before the accounts mature. For example, if fixed-term savings are withdrawn before maturity, the resulting interest rate paid could be below the base rate paid on passbook savings.

No interest on savings is paid to clients who are delinquent on their loans (principal or interest). The interest is either withheld or applied directly to the delinquent loan. Clients with delinquent loans may not withdraw savings until their loans are brought current. In credit unions, the earnings dividends on shares are also withheld when a member is delinquent on loans.

Claims on returns priority. Claims on savings accounts returns follow this order:

- Fixed-term certificates of deposits have first claim on earnings. The savings institution has entered into a contract with the saver and the return on these deposits must be paid at the rate and time stated in the contract.
- The interest return on programmed savings accounts is paid after fixed-term deposits.
- The interest returns on passbook savings are paid after the returns contracted in fixed-term and programmed savings have been paid.
- The dividends earned on member shares are paid last, after payment of all savings liabilities. Where earnings are not available, dividends are reduced or eliminated. Where a credit union's institutional capital does not meet capital adequacy standards, the dividend on member shares may be suspended to allocate earnings to reserves until capital adequacy is restored.

Savings Management

Effective savings management requires liquidity management, procedures for handling cash on hand, and internal controls for managing non-financial risks.

Liquidity Management

Liquidity reserves. Sound liquidity management is essential to ensure that funds are available for clients to withdraw their savings. Liquidity management requires a reserve percentage calculated on all withdrawable savings and deposited in other formal financial institutions. The liquidity reserve should be 10 percent of the deposit portfolio. The liquidity reserve should be invested in low-risk, liquid financial instruments with a high level of security; it should be interest earning.

When credit unions shifted their focus from illiquid shares (forced savings) as the primary source of funds to withdrawable, voluntary savings, some managers and regulatory officials voiced concerns that such savings funds would be highly volatile and unstable. With the transition to voluntary savings, credit unions found that there was indeed movement of cash in and out of the liquid accounts. But they also found that this movement comprised only a small percentage of the total volume of funds. As long as savers had confidence in the safety and soundness of the institution, the many small accounts, primarily passbook savings, tended to be stable. Larger savings accounts, on the other hand, tended to be more market-sensitive and to move rapidly with changes in market interest rate levels. In other words, credit unions found that the real liquidity risk did not stem from the many small, liquid accounts, but from the few large accounts, which made up a large percentage of the total volume of savings. These large accounts were likely to move without warning as shifts in the market occurred.

A high concentration of savings in a few large accounts will expose the savings institution to high liquidity risk. Large accounts tend to be very market-rate sensitive, and the rapid withdrawal of one or more of these accounts could leave the savings institution with insufficient cash to meet its withdrawal or disbursement requirements. Yet there is no advantage in turning away these large savings accounts. To mitigate the large-account concentration risk, some credit unions maintain the standard liquidity reserve of 15 percent of deposits for all accounts below a certain threshold and a liquidity reserve of 20 to 25 percent of accounts above the threshold. The higher reserve rate compensates for the higher liquidity risk of deposits concentrated in the large accounts.

Asset-liability management (ALM). Savings institutions must carefully manage their assets and liabilities to prevent asset-liability mismatches in terms and rates. For example, liquid passbook savings which can be withdrawn from the savings institution immediately are not safe sources of funding for long-term loans which are paid back to the institution over a long period.

Savings institutions should try to match the terms for loans granted with the terms of the deposits mobilized. Short-term savings funds should be invested in short-term assets. Savings institutions should finance short-term loans with funds obtained through current and short-term deposits and medium-term loans with medium and long-term deposits. Longer-term loans are often funded with illiquid shares in credit unions or with longer-term, external sources of credit.

Savings institutions may face earnings problems if they take in short-term savings at one rate and then lend them out for a longer term at a fixed rate. If the market rates on savings rise, increasing the finance costs to the savings institution, while the earnings on loans or investments remains locked in for longer terms, the institution will suffer a squeeze on its earnings. In the same way that liquidity management requires a balance between terms on savings coming in and loans going out, earnings management requires a balance between interest rates on savings and the loans they fund. Lending at variable interest rates rather than fixed interest rates can decrease the risk of rate mismatches.

Central liquidity pools. In many credit union systems, the liquidity reserve is pooled in a second-tier entity, such as a central finance facility (CFF). These CFFs collect and reinvest the funds in large amounts for higher returns than one credit union could earn. The abilities of credit unions to safely manage liquid savings are supported by their abilities to cooperate as a system. To receive the liquidity reserves of credit unions, the CFF must meet the same prudential standards that credit unions have to meet to attract the savings of individual members. The CFF holds the required liquidity reserves of 15 percent of deposits, but competes with the wider financial market for the additional liquidity reserves that credit unions hold. The CFF operates as a source of system-wide liquidity and an internal transfer mechanism that shifts funds from credit unions that have excess liquidity to those that are short of liquidity but still meet sound underwriting standards.

Access to a liquidity pool support mechanism such as a CFF reduces the amount of cash an institution must hold in-house. Daily management of the non-earning cash needed for operations should reduce cash to only what is necessary to cover demands for savings withdrawals and loan disbursements. Cash holdings should be kept at a minimal level of 1 percent of deposits. Institutions that do not have access to a CFF should negotiate with a formal financial institution to establish a line of credit for backup liquidity.

Inter-institution operations and transfers. A CFF may also serve as a central clearing house among institutions. Credit union networks provide services for deposits, transfers, and savings withdrawals between credit unions to benefit members regardless of where they are. In other words, members of a credit union in one town may enter a credit union in another town and make deposits or withdrawals on their savings accounts. Transactions are verified and cleared through the network's central clearing facility. With a national network of points of service, the credit unions can better compete with other financial institutions.

These inter-institution transfer procedures require security and account verification, but they are fairly simple. If the objective is to transfer funds from one institution to another to manage liquidity, the CFF ensures adequacy of funds by requiring all participating institutions to deposit the liquidity generated by business activities within a specified number of days. If the objective is to establish and present an image of a safe and sound system in which all participating institutions adhere to the same standards, the challenge is in establishing risk controls that are adhered to by all institutions. Participating institutions must have confidence in one another for this type of system to function. They must operate with the same financial standards, consistent policies, similar products, and uniform customer service standards. A networked system also requires appropriate technology and communications infrastructure to support the transaction requirements.

Cash Management

Many institutions operate today without taking deposits, providing only credit services. Some savings-based institutions rely exclusively upon payroll deduction as their source of funds. The strategic decision to accept cash deposits requires the establishment of procedures and controls to protect the integrity of the cash management.

Teller space. Teller counters must provide security and adequate workspace for tellers. At a minimum, teller counters must have drawers that can be locked, with cash trays to organize bills and coins. High-traffic lobbies should have grills or glass partitions in front of the teller counters.

Adding machines with tapes should be easily accessible at all teller stations. Adding machines with tapes minimize teller errors and omissions. The tapes also serve to document the daily activities, and are helpful to have in the event that the teller drawer does not balance.

Daily procedures. Each morning, before the savings institution begins operations, the head teller retrieves the teller cash from the vault. The money should be kept in a locked container inside the vault. Each teller has keys to his or her cash drawer, but not to the vault. A predetermined amount of cash is prepared in each cash drawer on the previous day. As transactions increase, it may be necessary to increase the amount prepared for the daily cash drawers. Each teller verifies the cash amount in the teller drawer. The teller lists on a report the number of bills of each denomination, their subtotals, and the grand total. An adding machine with a tape should be used to add the cash; the tape is dated, signed, and attached to the report. Each teller completes a Teller Balancing Report to record cash inflows and outflows. The teller begins by writing the opening cash figure on the Teller Balancing Report.

Teller drawers. The teller drawer has a cash tray with separate compartments for each denomination and type of coin. The cash bills are arranged in sequence facing up: the smallest denomination to the largest across the front of the money tray. Small bills should be within closest reach, as the tellers will use them the most. Larger denomination bills and strapped currency (strapped in bands of 100 pieces) are placed in the back of the money drawer or in another locked drawer in the teller stall. Loose coins are kept in a separate coin tray or in the coin compartment of the teller cash tray.

One person uses and is responsible for each teller drawer; only that person has the key to that specific teller drawer. Teller drawers should not be accessible to other employees or to the public. When tellers leave their stations, they should lock their cash drawers and log off their computer systems, where computers are used.

Keys to teller drawers must be carefully controlled. Extra keys for each drawer should be inserted into envelopes and sealed, with each teller signing over the seal to his or her key. If the seal is broken, a teller will know that someone has accessed his or her teller drawer. The extra keys should be kept in the safe and controlled by management or appointed staff.

Opening procedures should follow the same sequence every day:

1. Head teller retrieves funds from the safe,
2. Tellers arrange in teller stations,
3. Tellers count funds in cash drawers to verify opening amounts,
4. Tellers fill out vault tickets to "purchase" additional cash; they count the additional cash "sold" to them for the day and put all cash away in teller drawers, and
5. Tellers record the opening cash figure on the Teller Balancing Report.

Teller Balancing Reports. At the end of each day, tellers complete Teller Balancing Reports on the computers or on printed forms. If tellers use printed forms, all additions and subtractions should be made with an adding machine, with the adding machine tape then attached to the Teller Balancing Report (example shown in Figure 3.7.). "Receipts in" and "withdrawals out" tickets are also stapled to the report. A teller:

1. Records the bill and coin totals from the end of the previous day.
2. Records the vault cash "purchased" and "sold" tickets.
3. Records the "cash in" tickets (cash deposits).
4. Records the "cash out" tickets (cash withdrawals).
5. Records the number and the amount of each denomination and coin in the proper box on the form.
6. Totals the checks.
7. Totals the cash and checks in the drawer, and enters that amount in the Total Cash and Checks box on the report. The total cash and checks amount should agree with the closing cash amount on the top of the Teller Balancing Report.
8. If the Teller Balancing Report balances, the cash is stored in the vault.

Outages (drawer out of balance). If the teller drawer does not balance, the teller reviews the accuracy of the recorded opening cash, vault tickets, receipts, withdrawals, closing cash, cash amount, and checks. If the outage still has not been found, the teller rechecks every transaction made during that day, using the adding machine tapes to review the items one at a time. The teller checks to see that the proper form for each transaction has been used.

The drawer will be over if:

- A deposit ticket is missing from a deposited check;
- A deposit ticket is missing from "cash in" tickets; or
- A client withdrawal form has been included but there is no "cash out" ticket.

The drawer will be short if:

- A withdrawal form is missing from the "cash out" tickets;
- A client deposit form has been included but does not have a corresponding "cash in" ticket or check; or
- A client withdrawal form has been included but does not have a corresponding "cash in" ticket or check.

If the outage cannot be found, the outage is entered into the "over" or "short" box on the Teller Balancing Report. If the drawer is over, the amount is subtracted. If the drawer is short, the amount is added. Tellers are required to pay short outages. Teller outages should be rare; more than three occurrences should result in dismissal.

Internal Controls

Savings institutions incur non-financial risks in receiving cash savings from members and clients. Those risks include employee fraud, robbery, employee endangerment, monetary errors, and losses due to fire or vandalism. Management of such risk requires security measures, proper equipment, staff training, internal control procedures, and confidentiality of account information.

Security measures. Secure infrastructure requirements include locked drawers at teller stations, vaults for holding cash, and grill or glass partitions between teller stations and the public. Grills and bars

Figure 3.7 The Teller Balancing Report

SAVINGS INSTITUTION

TELLER BALANCING REPORT

Teller: ______________________ Date: ______________

RECEIPTS			CASH COUNT		
Deposits			Bills		
Entrance Fees			500's		
Late Charges			100's		
Interest on Loans			50's		
Loans			20's		
Total receipts from members			10's		
Miscellaneous			Coins		
Income from Investments			Ten dollars		
Other Income			Five dollars		
Other (list below)			One dollar		
			0.25's		
			0.10's		
			0.05's		
Total cash receipts			Total Money		
Opening change fund			Checks & Drafts		
Change Fund Increase			Last name		
			Last name		
Total Cash			Last name		
			*Total		

DISBURSEMENTS:					CHANGE FUND RECONCILIATION		
Can share withdrawals					Opening Change Fund		
Checks Cashed							
Cash Loan Payments					Increase		
Other (list below)							
					Decrease		
Total Cash Disbursed					Closing Balance		
Change Fund Decrease							
Total Disbursements					Change Fund Cash Inventory		
Change Fund and Net Cash Proceeds					Needed for Replenishment		
Cash Over (or Short)							
*Adjusted Balance					Authorized Change Fund		

Receipt of the total amount shown in the cash count column is hereby acknowledged.

* Balance must agree ______________________ Cashier

should be in place over doors, windows, and air conditioners. Alarm systems should connect with local police stations or security companies. Management should know ahead of time how police will respond to an alarm or robbery.

Guards should be present in larger institutions, and trained in what to do in the event of a robbery. Training of all staff is necessary to ensure the safety of the employees. The security training should teach employees how to act in case of robbery and what steps to take after the thief has left the building.

A vault (or safe) is used to keep:

- Legal documentation backing up loans and investments;
- The metal box containing cash;
- The blank sequentially numbered forms, including receipts and checks; and
- Expense vouchers and documentation.

Custody of the vault should be dual; that is, the responsibility of two people. If the vault has two combinations, one person has the combination of one side and another person has it for the other side. If the vault has a combination and a key, one person will have the key and the other will have the combination. The combination or key to the vault must be changed immediately when either of the two persons with custody changes. A written copy of the combination and a duplicate of the key to the vault should be deposited with another institution in a different location. Finally, the vault must be fireproof.

Access to the teller and vault areas by persons unrelated to the cash operations should be restricted. Internal control policies regulate the maximum amount of cash kept on hand in order to minimize potential losses and to avoid endangering the persons responsible for handling it. The amount of cash on hand should not exceed the insurance coverage for cash losses.

The total amount of money received, either by check or cash, in daily operations should be deposited into a formal bank account. The total of this daily deposit serves as a verification of the total daily income report.

Internal control procedures. Internal controls for savings management are implemented through rules for common transactions, such as:

- All teller transactions are to be documented with receipts.
- All passbook entries and receipts should contain teller identification.
- Tellers are not permitted to hold or keep client passbooks at the institution.
- No official or employee may transact business on his or her account or on a family member's account.
- Employee and official accounts and, if desired, family member accounts are to be reviewed by the internal auditor or supervisory committee for unusual or abnormal activity on a quarterly basis.
- All clients should be notified immediately in person, telephone, or writing if a deposit error occurs.
- All change of address requests must be in writing and signed by the client.
- Account closures must be in writing after the presentation of proper identification.
- When an account is closed, the signature card is to be promptly pulled from the active account file and placed in a closed account file.
- A list of closed accounts including account number, client name, and reason for closure is maintained by the manager and available for review.

Savings institutions must maintain a separation of functions. The employees who approve or conduct business or transactions in the organization should not be the same ones who do the processing, prepare accounting entries, and maintain the internal part of the transaction. The administration function should take charge of those duties.

The manager, head teller, or person in charge of accounting is responsible for the general cash in the vault. The manager or head teller should conduct daily surprise cash counts to make sure that there are no discrepancies in the daily activities. The cash count covers the daily money in the teller drawers, as well as the daily money kept in reserve in the vault. The total of the cash count must be equal to the ledger account of the same date. The person in charge of conducting the daily cash count should collect the cash assigned to each teller and should deposit it in the vault. This same person is responsible for collecting cash that exceeds the amount authorized for each teller and for providing tellers with new funds when their drawers are short of the authorized amount.

All the deposits and withdrawals on savings accounts should be handled by the person in charge of the general cash and included in the daily activity report. The teller notes down the respective accounting entries affecting each account on the vouchers. The accountant or another designated person maintains auxiliary records in the name of each account holder with the activity and balances up to date. The sum of these records must equal the amount recorded in the appropriate ledger account.

Confidentiality of account information. The personnel of a savings institution must not reveal to third parties any information regarding the savings or deposits of clients, unless the third party produces written authorization from the saver or if there is a written order from a competent authority in accordance with applicable law. Account information is confidential, available only to the depositor and his or her beneficiaries or legal representatives.

Conclusion

Savings mobilization is a demand-driven activity aimed at clients who wish to save using financial instruments. As such, the savings institution must offer savings products that satisfy the demands of local clients. Savers look for a savings institution that can provide them with safety, convenience, and return, in that order of priority.

Savings services are designed by trading off liquidity (or access) with returns (compensation). A continuum of savings products can be designed, ranging from passbook accounts, which offer complete liquidity and lower returns, to fixed-term accounts with restricted liquidity and higher returns. Low-income and small savers generally prefer to have complete access to their savings accounts, whereas larger and wealthier savers will sacrifice liquidity in order to obtain higher returns on their savings. Products are also designed by tailoring them to the demands of particular market niches (for example, farmers or youth), or to purposes for which clients save (for example, education fees or housing). Product design must be simple and clear to attract savers and to keep administrative costs low.

The credit union experience in mobilizing voluntary savings has focused primarily on six savings products: passbook accounts, fixed-term certificates of deposit, youth savings, programmed savings, institutional accounts, and retirement accounts. The most popular savings product is the passbook account, followed by fixed-term certificates of deposit and programmed savings accounts. Products are defined by their core characteristics: target market, interest rate, minimum opening deposit, minimum balance requirement, withdrawal policy, promotion, and institutional implications. Each type of product offers advantages and disadvantages for the saver and the savings institution.

Passbook savings tend to be characterized by many small accounts. Larger accounts help spread the fixed costs; moderate-sized accounts provide the base of funds. Smaller accounts tend to be more stable while larger accounts are interest rate sensitive and can be volatile. The larger accounts must be managed with stronger liquidity reserves in order to offset the concentration risk.

Interest rates are the price an institution pays for receiving savings; the rates vary with the product offered. Interest rates should be competitive with market rates, cost-based, in accordance with the business plan of a savings institution, and positive in real terms (above the rate of inflation). They should be adjusted as market conditions change. Interest rates vary with certain characteristics of products: minimum balance required, liquidity, and transaction costs. Savings products are designed to vary positively with the amount in accounts to provide incentives to savers for increasing their savings on deposit. Interest rates also vary with the term of the product to compensate savers for the restricted liquidity of their savings.

For those institutions that have not offered savings services previously or have received savings only via payroll deduction, the reception of over-the-counter cash deposits introduces a new set of risks. The institution must put into place procedures and internal controls for opening accounts, withdrawals, safe and teller cash management, as well as liquidity management.

Credit unions that have assessed client demands and offered innovative products together with solid returns have been successful in mobilizing savings and increasing outreach. MFIs will be able to offer the most effective savings services where they have designed demand-driven products, established frameworks for managing those products through clear policies and procedures, and set up systems to minimize the non-financial risks associated with savings mobilization.

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Chapter 4

Product Development and Marketing: Meeting the Local Demand

José Linares Fontela

Product development and marketing efforts focus on meeting the local demand for savings services. Good product offerings and effective marketing will result in a successful savings mobilization program that will lead to growth in the institution.

The first step in determining how to meet client demand is to find out what clients and potential clients want in their savings services. Once that information is obtained, savings institution managers should evaluate existing products to see if they meet those demands. Various sources of information can be used to evaluate products and services, including staff observations, client complaints, market research, competitor activities, and national financial market behavior. When existing products do not meet the demand for savings services, new products are developed to fill the void. Staff training should be part of the product development process. In addition, a product manual that contains comprehensive information about all products is essential. Information about policies and procedures should also be included in the manual.

A marketing plan provides the roadmap for product development and marketing efforts. An institution's marketing plan should be goal-oriented and based on sound business principles; the plan should help the savings institution to meet its business targets in a competitive marketplace. Even a small financial institution has many marketing tools it can use in a marketing program, including sales and cross-selling, selling in the field, media advertising, point-of-sale advertising, direct marketing, and promotions.

Savings institutions define strategies to encourage current and potential clients to use all the products offered by the institution. These strategies may be based on image, quality of service, rates of return, or a combination of these and other strategies. Branching enables an institution to offer convenience to clients and to cover the widest geographical area possible on a cost-effective basis.

Managers in a savings institution should have a vision for the future. This vision is carried out through a long-term development strategy, which is broken into short-term actions that, through effective planning, work together to achieve the vision. Long-term planning, short-term planning, and marketing planning help managers to stay on track with their development strategy. Profitability planning is also necessary, since managers must be able to determine whether their savings strategy is sustainable. Institutional growth will accompany savings mobilization. Through planning, managers can manage growth without compromising quality of service.

This chapter provides guidelines for assessing the demand for financial products, product development, and developing a marketing program for savings mobilization. The chapter emphasizes the need for maintaining a high level of client service at all times, as well as the need for the institution to provide a sense of security to clients.

Existing Products: Do They Meet Client Demands?

When we buy a car, we may prefer a particular brand name, perhaps a Ford. We must also choose the model of car we want: a small car or a luxury car, for example. Once we decide on the model, we select which options we want, such as air conditioning or a stereo. In the same way that features help us to decide which consumer products to buy, they also help us to decide which financial products to buy. The features on which we base our final decision are:

- **Brand:** the name of the car's manufacturer;
- **Model:** the name that identifies a particular type of car made by that manufacturer; and
- **Options:** features that distinguish each car.

This same product structure applies to financial products offered by microfinance institutions (MFIs):

- **Brand:** the financial institution's name (reputation);
- **Model:** financial services offered by that institution (for example, savings, credit, or insurance); and

- **Options:** features that distinguish one savings product from another (for example, passbook account versus certificate of deposit).

Clients evaluate the brand strength, models offered, and options available when determining where to deposit their savings. Historically, financial institutions have not offered their clients many options. Now, however, as financial institutions face increased competition and more sophisticated clients, they have to offer models and options their clients demand, at prices they are willing to pay.

The key word is *demand*. Client demands have transformed the financial marketplace. The new reality of fierce competition and more sophisticated clients has prompted radical changes in operating models. Formerly, these models were driven by the belief that because people needed financial institutions and had limited choices, client preferences were not very important in product development. There was a time when a financial institution's trustworthiness and the financial security it represented (its brand) were all it needed to attract clients. Today, brand is one variable among many in attracting clients.

Trustworthiness and a sense of security are crucial elements to the continuing existence of any financial institution. But what happens

Evaluating product offerings. When thinking about existing financial products and services, managers and employees in a savings institution must ask themselves:

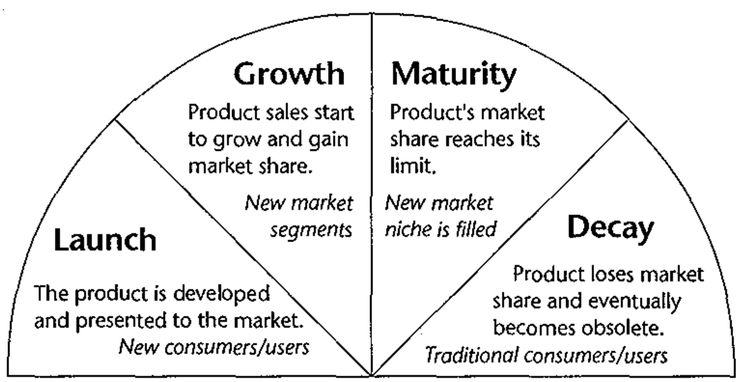
- Does our institution portray a positive, safe image?
- Do our products address client demands?
- Are our products up to date?
- Are our products attractive to existing clients?
- Are our products attractive to the broader market of potential clients?
- Are our products profitable?
- Do our products match or outperform those offered by the competition?

when several financial institutions offer the same qualities? Clients will then make their choices based on the brand, model, and options offered by the institution that best meets their financial needs. Financial institutions with a solid reputation must differentiate their models and options from the competition. Realizing this, successful savings institutions design innovative products and undertake rigorous marketing efforts.

The Product Life Cycle and Savings Products

The product life cycle is a useful model for understanding the process of product development (shown in Figure 4.1). Beginning with a product's launch and ending with its eventual decay, the model shows how all products ultimately become obsolete. The timeline for the process varies from one product to another. For example, clothing fashions have a short life cycle while housing styles have a long life cycle. For each phase of this model, specific strategies can be applied to lengthen the life of the product.

Figure 4.1 The Product Life Cycle



Evaluate existing savings products. Product development begins with an evaluation of the existing financial products and services offered by the savings institution. The next step is to determine where each product is in its product life cycle. Then, managers select the appropriate marketing strategies for existing products based on where each is in the life cycle.

Redesign existing savings products. This is a continuous strategy that will lengthen the life of savings products. It includes several actions that can be taken during the growth and maturity phases of the product life cycle:

- **Update and repackage:** Use this approach when a product reaches the maturity phase and needs to be modernized. Updating a product makes it attractive to new clients in a particular market segment, while keeping it acceptable to existing clients who are the traditional consumers of that product. Repackaging does not change the core characteristics of a product; rather, repackaging modifies a product's physical appearance to make it more attractive to more clients. An example might be the repackaging of a savings passbook. Traditional passbooks are usually visually simple. Clients who have used the passbook for many years are accustomed to this simple graphic style. Prospective clients, however, may find the style dull and unattractive, and hence, view the institution in that same way. To keep the product viable, a new passbook design is introduced. The new design is similar enough to the old design to keep the passbook attractive to existing clients, but sufficiently innovative and interesting to motivate new clients to open accounts.
- **Add options:** Add options during the maturity and decay phases of a product, especially when decay is the result of technological growth. Analysis of a demand savings account illustrates this strategy. Traditionally, the demand savings account was associated with a passbook. Technological developments and the introduction of automatic teller machines (ATMs) prompted advanced institutions to provide plastic debit cards for these accounts. Many traditional users did not like the plastic cards and continued to use their passbooks. Eventually plastic cards displaced the old passbooks entirely. This shift came about for practical reasons. Using a plastic card rather than a passbook not only allowed for the purchase of goods in shops and the use of ATMs, but it also reduced the need to withdraw money regularly—reducing

transaction costs for clients. To complement the plastic card, monthly account statements listing all transactions on the account replaced the passbook for client record keeping.

- **Improve product delivery:** Implement this strategy during any phase of a financial product's life cycle to improve the quality of service delivered by the institution. Technological advances generally lead to higher quality services. Staff training and incentives will also improve product delivery. Remodeling branch offices will please existing clients and attract new ones. All operations that a savings institution engages in while doing business can be adjusted to improve product delivery. Such improvements can have significant impact in attracting new clients and reinforcing the loyalty of current clients.

Discontinue a savings product. Discontinue a savings product when it becomes obsolete. A product is obsolete when it has been replaced by other options in the financial market that simplify transactions or better serve client demands. In the product life cycle model, obsolescence is the final phase during decay. At this point, only a few clients use the product; however, those clients may represent an important market segment. If the product is replaced, they might move their savings to another financial institution. This possibility must be factored into the decision to discontinue a product that has reached this final stage.

Develop new savings products. New demands and new patterns of financial behavior often arise. New financial products are designed and launched into the market to meet these evolving demands through the process of new product development. New product development is discussed later in this chapter.

Define the Market, Differentiate Market Niches

The financial market, especially the microfinance market, is not a uniform collection of people who will be satisfied with whatever products and services financial institutions offer. Market research conducted in a number of countries has disproved this old perception and given way to a new vision. The new vision defines the financial marketplace as a complex structure of groups and niches of financial product users who have varying demands and preferences. The first step in serving this segmented market is to identify clients based on how they use financial products.

Non-savers or first-time savers. This group has little or no formal financial experience. It can be difficult to persuade prospective clients from this group to open savings accounts because they are accustomed to saving in cash and in alternative forms. Because these clients lack experience entrusting their savings to a financial institution, they will most likely seek liquid products with low minimum balances. First-time savers are usually motivated to start saving in an institution by a need for security and a desire to avoid the risks inherent to saving in cash or alternative forms. First-time savers generally remain loyal to the savings institution as long as the institution remains secure and provides convenient services.

Experienced savers or net savers. Members of this group have formal financial experience and may have established accounts with significant balances in other savings institutions. They are familiar with handling savings accounts. Many are comfortable using ATMs, and some may use plastic debit cards to make purchases. Their principal

Changing existing perceptions. Individuals may have mistaken perceptions about the differences and similarities between credit unions and other financial institutions. Credit unions are perceived by many as lending institutions rather than as savings institutions. It is not surprising, then, that some members will look to their credit unions for loans while saving their money elsewhere. Where members do not automatically associate their credit unions with savings, the institutions must offer higher rates on savings, develop targeted products, and vigorously market these products. Credit-only MFIs will face similar challenges when starting savings programs, as they too will have to change existing perceptions of their institutions. The examples and case studies presented in other chapters of this book demonstrate that it is possible to make this transition.

concerns are security and convenience, but members in this group will also consider rates of return when choosing savings products. Their brand loyalty is constant if their objective is to prepare for emergencies or to save for the future. If they are motivated by the desire to make money on their savings, they will be loyal as long as the return paid by the institution is the highest in the local market.

Sources of Information

All products and services must be evaluated regularly to identify their limitations and determine the need for changes. Product development is based on the defined demands of current and potential users. The information needed to identify these demands comes from various sources: staff observations, client complaints, market research, competitor activities, and national financial market behavior.

Staff Observations

The staff understands problems associated with an institution's products and services in two ways:

1. Staff members have direct contact with clients and receive direct feedback on the products.
2. Staff members are able to see and evaluate problems associated with the savings products because they know how the products function at the operational level.

An open system to collect and process employee suggestions and complaints should be part of an institution's standard operating procedures. Since information obtained from staff represents a small sample, market research must be performed to confirm observations noted by the staff.

Client Complaints

A savings institution should have a process that allows clients to formally convey their complaints and suggestions. Accessible suggestion boxes are effective mechanisms to solicit client input. Once the information is collected, it should be evaluated carefully to identify strengths and weaknesses, and indicate where more research and development are needed. Information collected from clients can only be used as a general indicator. Unless every client complaint pertains to one particular issue, which should prompt immediate action on that issue, the number of samples gathered will be too small to provide the basis for informed decisions. The indicators collected from client comments need to be verified by market research before managers can reach solid conclusions and determine appropriate responses.

A three-part form can be created for processing complaints. When the complaint is received, the first part of the form is completed. A copy is given to the client and another copy is given to the head of the department noted in the complaint. The department manager must then investigate the complaint, complete the second part of the form, and return it to the manager in charge of addressing client complaints. The complaint manager decides on a course of action to satisfy the client and completes the third part of the form. Then the client complaint is resolved. The completed form is saved, so the institution can generate statistics about the particular issue and the staff associated with it. These statistics reflect the seriousness of the problem and the impact on business. They also identify the staff members who accumulate complaints, allowing managers to take action as necessary.

Market Research

Market research provides useful information about the demands of clients in the local market. Market studies can be designed to determine the validity of an issue brought to light by staff observations or client complaints. Market research also provides information needed to design new products or adjust existing products.

Table 4.1 lists often-used market research tools. Tools such as surveys and focus groups provide insights into the competitive position of products and the reputation of the institution. Surveys are closed, quantitative tools distributed to a significant sample of interviewees. The significant sample size methodology ensures the statistical validity of the information. Focus groups are not as statistically precise as surveys due to the smaller samples and the open, qualitative nature of the methodology; however, they provide insights that quantitative methods cannot produce. Other research tools include pilot testing and in-depth interviews. The most effective market research combines tools so that both quantitative and qualitative information is obtained with a high level of statistical confidence.

Successful marketing requires concrete research to detect trends

Table 4.1 Market Research Tools

Tool	Advantages	Disadvantages
SURVEYS Surveys are the most frequently used tools in market research. They are usually conducted via questionnaires that are distributed to a sample population representing a particular statistical universe (e.g., clients, women, or married people).	• Surveys have a high level of confidence because they involve a significant number of interviewees. • Surveys use a tested questionnaire that is completed by each member of the sample population.	• Surveys are expensive because several people have to get involved in fieldwork, supervision, and processing of information. • Surveys work on a closed basis; survey questions are predetermined by the questionnaire and the interviewer cannot ask any questions except those prescribed by the questionnaire so that the statistical quality is preserved.
FOCUS GROUPS Focus groups provide researchers with qualitative insights. They usually involve small groups of about ten to 15 participants and a discussion leader who explores the issues using set guidelines. Sessions are recorded and evaluated afterward. The tool fosters freedom of opinion and allows the group leader to explore the issues. Their main uses are to design surveys and to evaluate product concepts and advertising campaigns. Focus groups can include a set of surveys that are distributed to the group participants who, after completing the surveys, discuss the issues of each survey.	• Focus groups take into account the qualitative element of participants' demands and perceptions. • The participants devote time to discussing the issues. • The group leader can explore new and interesting leads that detail possible solutions or ways to improve products. • If a mixed technique is used (surveys and discussion) more representative information will be obtained. • Focus groups cost less to run than administering surveys. • The results are obtained and processed faster than those of a survey.	• The samples are small. Even if the researcher is running several focus groups, the level of statistical confidence in results is low. • It is difficult to assemble the groups and frequently sessions are suspended for lack of a quorum. • Unless a mixed technique is used (surveys and discussion), the level of confidence is not high, and the conclusions may have to be validated with a survey.

and to respond to them; therefore, a savings institution must have a budget for market research. The marketing manager must combine the research tools in such a way as to generate the needed information as often as necessary, while remaining within the budget constraints of the marketing plan. This means that each research project must be carefully designed to produce information that will be valuable in evaluating existing products and developing new ones.

Table 4.1 continued Market Research Tools

Tool	Advantages	Disadvantages
PILOT AND TEST MARKET TRIALS Trials are useful for testing changes to existing or new products on a limited and controlled scale, to evaluate operational aspects and client acceptance.	• Avoids costly mistakes of a product being put into production and later having problems. • Maintains a controlled environment in which to observe the product conditions and correct any abnormalities. • Reduces the costs of making adjustments.	• It takes time, so the product will take longer to reach the market. • The cost will be added to the product development costs.
IN-DEPTH INTERVIEWS This research tool consists of a sampling of people who fit the profile of the desired members. An expert interviews participants following a set script. This technique is useful to explore general aspects of collective behavior.	• Due to the number of samples and the use of a set script, the level of confidence is high and tendencies are readily observable. • Detailed information is collected. • The interviewer is a trained professional; this ensures higher quality than when regular survey interviewers are used. • When the same professional who conducted the interviews processes the results, significant information about the market is acquired.	• Its high cost is prohibitive for many institutions. • It is time consuming. • Results will depend on the quality of the professional in charge.

Competitor Activities

Financial markets are subject to constant changes and adjustments that stem from the actions and reactions of competitors. When a financial institution launches a new product or revises an existing one, it prompts a response from its competitors. The competition must be monitored continuously if a savings institution is to respond quickly to changes in the local market. Monitoring the competition is more an intelligence gathering activity than a market research activity. Monitoring ranges from collecting the competitions' advertisements to hiring "mystery clients" to visiting competitors' offices in search of information.

National Financial Market Behavior

Central banks offer statistics, both current and historical, on the behavior of financial markets and regulated financial institutions. This information may also be accessed through the Bank for International Settlements (www.bis.org/cbanks.htm) and the U.S. Federal Deposit Insurance Corporation (FDIC) (www.fdic.gov). The *MicroBanking Bulletin* provides statistical information for MFIs worldwide (www.microbanking-mbb.org). Accessing this information, via either the Internet or buying the printed publications, is part of researching market trends. This information can help managers to understand changing global patterns that must be considered when adjusting existing products or developing new ones. It will also alert them to new regulations that could affect their operating procedures.

Savings products are designed to meet the demands of clients. Unsatisfied clients will look for other options in the marketplace and take their business elsewhere. Prospective clients must be persuaded to bring their business to the savings institution. This is achieved by offering innovative and targeted products that are well managed.

The New Product Development Process

A new savings product must go through a series of developmental stages. First, the market must be researched to determine if there is sufficient demand. Second, a concept must be designed and tested, internally and then externally. Finally, the product is launched.

Determining if There is Sufficient Demand

Because developing and launching a new savings product can be costly, the financial institution must ensure that the new product is justified. In some cases, adjustments to existing products can fulfill a perceived need for a new product. All avenues for adapting an existing product to meet unfilled demand should be explored before a new product is developed. Given the high cost of developing and launching new products, and considering the risk involved (the new product may not be successful), it is important to confirm the need for the new product through market research.

Designing and Testing the Concept

Once the institution has identified a need and determined that no existing product meets that need, a new product concept must be formally defined. This includes a description of the envisioned product or service and guidelines on how it will function. This concept must then be validated in the market through qualitative market research (such as focus groups or in-depth interviews).

The internal development process should generate a prototype of the financial product. This may require assigning development modules to each operational area of the institution. The following departments may be involved:

- **Product development** designs the prototype.
- **Marketing** creates and tests the packaging, symbol, and brand.
- **Management Information Systems (MIS)** develops software to manage the product.
- **Legal affairs** draws up the contracts associated with the product.
- **Accounting** sets up the product's accounts.
- **Internal auditing** develops internal controls related to the product.
- **Savings and loans** establishes the operating policies and procedures.

Once a prototype has been designed, it is pilot tested to identify and remove any design flaws. Initial testing of the prototype can be done using the staff of the savings institution. This takes about one month to complete. Then the prototype should be tested with a group of clients in a controlled market. This involves promoting the product in one of the institution's branch offices or in a targeted market, and conducting follow-up market research with the test group. Test marketing of this nature is necessary to (1) see if the product is viable and attractive to clients, and (2) correct flaws in the prototype that can only be identified in the real market. This kind of pilot testing takes about three to four months to complete. If the tests are successful, the new product is ready to be launched in the marketplace.

New Product Launch

Marketing new products requires an aggressive approach. A significant launch effort must be carried out to provide the new product with enough momentum to bring it to the attention of potential users. This may require a mass media campaign. The campaign targets current and potential clients who seek savings services. New product awareness can also be enhanced through promotions such as instant prizes or raffles. In the long run, the performance of a new product will depend on the awareness and motivation generated by the launch.

New products mean new information for the staff of an institution. Staff members should be trained on the launch campaign to know what messages clients will receive so they can reinforce them when clients visit the institution. Staff should also be trained on the new products so that they will be able to respond to client questions. Strategies for cross-selling new products to current clients should be devised as part of the launch process and shared with staff.

Bundling and Packaging of Products

Every new financial product is related to the other products and services offered by the institution. Each product can be considered a "module" that can be combined with other modules to create an appealing bundle or package. A package of modules can be tailored to the exact demands of each client or potential client. The ability to sell and cross-sell new products to clients will depend largely on how the design of one product complements the other products. When products are designed to be modular, links should be created between them in the management information system so that staff can immediately recognize which products might be attractive to clients. This will enable staff to answer client questions more effectively and better determine which products meet client demands. No single financial product can meet all the needs of a client. The objective should be to address a particular set of needs with a corresponding set of products.

The Product Manual

The product manual must be compiled and maintained as part of the process of product development. A product manual is a collection of information about each product offered by the institution. The first step in creating the product manual is to develop a standardized format to describe each existing product or service. This format is then used for all new products. The manual contains all the information, strategies, and changes made to each product. It should have one chapter for each product. Each chapter should include:

- An **introduction** that explains why the financial product was developed, what it offers, and the category into which the product is classified (savings, loan, or insurance).
- A **general description** of the product to explain its purpose, its advantages, and how it addresses client demands.
- A **detailed description,** listing the core characteristics and the steps for administering the product.

The Detailed Description

The detailed description of each product should include information on all aspects of administering the product.

Contracts and rules. Financial products are governed by laws, regulations, and the legal environment of the contracts signed by clients and the financial institution. Copies of regulations and samples of contracts should be filed in the product manual.

Forms, processes, and procedures. Samples of all account forms should be stored in the corresponding chapter of the product manual. Good governance requires that all procedures be documented and reviewed regularly so that everyone conducts them in the same way. To promote understanding, flow charts of the main processes related to the product should be included. These should be revised whenever changes are made to the product.

Packaging. The physical components of savings products are those tangible items that are touched and handled by users, such as passbooks, coupon books, or plastic cards. Financial products themselves are intangibles; they have no physical presence. It is important that the physical components are standardized and packaged attractively. The clients own these items; the items should instill a sense of pride and security in the clients. Samples of these items should be included in the corresponding product chapter.

Maintaining the product manual. The product manual is a formal document that must be maintained as part of product development and management. It should be updated when changes are made to a product. The old material should be retained in a separate archive to keep a record of the evolution of each product.

A hard copy product manual can be maintained in a three-ring binder with indexed dividers separating each chapter (each product). Every time a modification is made to the financial product, old pages can be taken out and new pages inserted to reflect the change. A revised table of contents should be added to the binder with a new version number and date. This allows staff to quickly identify the most recent updates.

Marketing and promotion. Each savings product requires a unique marketing effort, working under the umbrella of the institutional brand and within the marketing plan. Samples of advertisements, storyboards of television spots, texts of radio spots, brochures, posters, and so on should be filed with the product description. This file becomes a valuable reference for future marketing campaigns.

Profit and loss simulation models. Because all financial products must be profitable over the long run, simulation models should be designed and implemented to review the profit and loss situation. This analysis is particularly useful when changes in costs or income occur. Where possible, the information generated by the simulation models should be stored on computer CD-ROMs or disks so that simulations can be run when variables change.

The product manual should be designated as the primary location for all product information. The product manual is the foundation for effective product management; it supports marketing efforts, serves to train staff, and documents procedures to manage products efficiently.

The Essential Marketing Tools

To provide savings services in a sustainable manner, institutions have to broaden their outreach to attract clients of varying income levels. Savers in the local market need to know about the products available to them so that they can make informed choices about where to place their funds. Through marketing, an institution raises awareness about its products. Having developed products through a systematic process of evaluation, and having established systems for managing those products, a savings institution then employs marketing tools to penetrate the local market.

Sales and Cross-selling

Through active sales (attracting new clients) and cross-selling (offering new services to existing clients) an MFI can promote its savings products and increase its market share. The direct contact between the staff members and potential clients (sales) and existing clients (cross-selling) is critical in savings mobilization. The most frequent sales contact in savings institutions between the staff and clients is over-the-counter sales. During this contact, potential and current clients make important financial decisions, including whether to place their savings in the institution. Good client service establishes a rapport and trust between the employees and the clients. If a staff member mishandles an encounter with a client, all product development and marketing efforts are wasted. Staff must be well trained to conduct transactions and inspire confidence in clients.

Selling in the Field

Another environment for offering savings products is the potential client's home or workplace. Selling the idea that saving with a particular institution is more advantageous while in the potential client's own territory is not easy. Selling in the field is particularly challenging because:

- There may be several institutions covering the field with their business officers and salespeople.
- Potential clients may resist listening to the salesperson because they are accustomed to using a financial institution's physical facilities for this type of business.
- Savings products are intangibles. Point-of-sale (POS) advertising in the branches facilitates over-the-counter sales. In the field, however, POS support is not available.
- The field salesperson does not have access to his or her colleagues for quick information.

Despite these challenges, field sales can be profitable for a savings institution and provide a competitive advantage in a competitive market. Not all institutions have the resources to reach potential clients in their homes or workplaces. For an institution that competes on quality of service, field sales can decrease the initial transaction costs for savers.

Media Advertising

Advertising is one component of a successful marketing program. Advertising sends an appealing message or set of messages using the mass media. Electronic advertising (via television or radio) and print advertising (via newspapers, magazines, and billboards) can be expensive because of production, broadcasting, or circulation costs. Therefore, it is critical to ensure that the resources spent on advertising buy high-quality, targeted messages. Four criteria for effective communication are:

1. **Recall:** The advertising message should be clear enough that its viewers or listeners can remember the point of the message. If this does not happen, the message either does not appeal to the target audience or is too complicated to understand.
2. **Comprehension:** The message should be clear so that both current and potential clients understand the offering. In many cases, advertising is too obscure for easy comprehension; obscure messages will not prompt savers to act.
3. **Credibility:** The message should be sincere, and not seem too good to be true. Savers want to be able to trust in the institution that holds their money. If the message does not convey a sense of trustworthiness, the target audience will ignore it and existing savers may react negatively to it.
4. **Motivation:** The message should motivate people to visit the institution to find out more information or to use a new product.

Advertising has one fundamental objective: to encourage people to become interested in the message and to act. The action should be a visit to the institution's offices, either to find out more information about the products and services offered or to open an account. If this does not happen in significant numbers, the advertising campaign has not been effective and the institution needs to conduct further market research to find out why the message does not motivate savers to act.

At the same time, not all savings products are large enough to justify use of mass media. For example, using the mass media to market fixed-term deposits increases the marketing costs unnecessarily, since this market segment is limited and does not tend to respond to mass advertising. The decision to use mass media should reflect (1) the type of savings product being offered, and (2) the institution's ability to reach the target market for those products. If the target market is limited and can be reached using direct marketing tools, then the use of mass media is not justified because other tools would be more cost-effective.

Media Mix. In addition to a creative effort that addresses the content of the advertising message, there needs to be a media effort that determines the best media mix to communicate the message. The marketing staff should develop a price-value media plan that will cover the target markets. The media mix should take into account: the existing institutional image, the geographical presence of the institution, the structure and unique characteristics of the local market, the relationship between the products and their targets, and the communications strategy needed for each product.

The marketing staff can work with professional advertisers to combine the mass media elements to ensure the greatest presence at the lowest cost. Each medium has its strengths and shortcomings.

- **Television** is often the principal medium used in large advertising campaigns. Television combines image, sound, color, and movement. The television message is usually short and is not controlled by the viewer (that is, the viewer cannot decide when or where to view a television advertisement). Viewers recall about 70 percent of a television message, higher than for any other advertising vehicle. Television advertising, however, may be too expensive for many MFIs.
- **Radio** is an inexpensive medium that enables the savings institution to broadcast frequently, making its message a constant presence in the target market. Listeners do not control when or how often the message will be broadcast, but they should hear it at various times throughout their days. Marketing campaigns in MFIs are often developed

using only radio spots, but the absence of an image (picture or graphic) can be a serious drawback to their effectiveness. Where television is too expensive, an effective strategy combines radio with newspaper or outdoor advertising (billboards).

- **Newspapers and magazines** (print media) provide color and images. They are the only media controlled by the audience. Readers read at their own speed and only what interests them. Readers can also tear out an advertisement and use it for future reference. Printed media allow the savings institution to include detailed information that cannot be included in other media advertising. There are several drawbacks to print media, however. The per-person cost of reaching the target market is high, even given the number of readers for each publication (usually newspapers are read by two to three readers, while magazines can have up to ten). Members of the target audience have to be able to read in order to understand and act on the message. Savings institutions should conduct market research to analyze the reading capacity of the target audience before advertising in print media. Additionally, printed advertisements may compete for space with other ads on the same page, increasing the challenge of attracting readers' attention.

Point-of-sale Advertising

Point-of-sale (POS) advertising uses the physical space in the institution's offices to communicate with current and potential clients. POS advertising includes retail displays, such as countertop brochure racks, wall banners, and unusual three-dimensional objects that draw clients' attention to a particular message. More sophisticated resources include video monitors and interactive kiosks. These resources have two purposes: (1) they give clients something to look at (a distraction) while they wait to make transactions, and (2) they provide information about the financial products and services offered by the institution.

- A presentation shown on a **video monitor** provides constant information to clients and visitors, and requires almost no attention once it is in place. A presentation can last up to ten minutes and can be programmed to repeat automatically. The initial investment in equipment may be costly, but maintenance costs will be low. Once the investment has been made, the savings institution can create several presentations at little additional cost to convey different messages.

- An **interactive kiosk** is a personal computer with a touch-screen monitor and software that makes it easy for clients and visitors to select menus and options. Clients can review information that is of interest to them in a comfortable environment. Like video monitors, interactive kiosks require a significant investment in equipment and software at the outset, but are inexpensive to maintain. If the savings institution has a website, the interactive kiosk can familiarize clients with the site and provide instructions on how to use it.
- **Posters and acrylic displays** are affordable mediums for POS advertising. Letter-sized posters that are placed in acrylic bases can be printed on a simple ink jet printer. Even where posters and displays are printed commercially, advances in printing technology have lowered costs for small orders.
- **Window exhibits and banners** sell the savings institution's products and services to clients, visitors, and people passing by on the street. Creative staff members can produce them inexpensively with paint, posters, and other art materials.

Point-of-sale advertising is an important marketing tool that MFIs can use to attract savings deposits from both current and potential clients.

Direct Marketing

Direct marketing includes activities in which the institution comes in direct contact with current and potential clients in its zone of influence. The zone of influence is the area within a one-mile radius of the savings institution office or branch. Direct marketing activities include telemarketing, faxing, hanging overhead street banners, and distributing fliers. Direct marketing is designed to attract traffic in and around the office or branch and should supplement mass advertising efforts and promotions.

Promotions

Promotions are marketing activities designed to produce specific short-term results. Promotional techniques can be implemented in several ways.

- **Traffic-building promotions** draw potential clients into the offices to get more information about the institution and its offerings. Promotions can be as simple as setting out jars filled with coins, having clients and visitors guess the number of coins in the jar, and awarding a prize for the winning guess. If there is more than one correct guess, the prize is raffled among the correct guessers. Often, the prize is the jar of coins itself. When potential clients visit the office, the staff should be prepared to answer all of their questions and sell the savings products to them.
- The savings institution can offer **instant prizes** to provide incentives for clients to open certain types of accounts. For example, clients opening a new passbook account spin a wheel of fortune to win the prize indicated on the wheel. This type of promotion can also serve as a traffic builder for potential clients, with visitors receiving instant awards for coming in the door.
- A **two-for-the-price-of-one promotion** gives clients who open two accounts, such as passbook and fixed-term accounts, better rates for a limited period. This will not only attract new deposits, but it will also stimulate clients who would probably open only liquid accounts to open less liquid accounts as well.
- The savings institution can hire short-term workers to **leaflet**—to hand out fliers and promotional items. These workers should be uniformed, with a professional appearance. They should also be trained so that they can explain the advantages of the institution's products and services as they hand out the items. This tactic attracts new clients. A car with a megaphone and a tape recorder that plays music and messages may accompany the leafleters to attract people's attention.

- Raffles are widely used as a promotional technique. Raffles are attractive to clients because they tend to offer better prizes than those offered in the instant prize promotions. For the institution, raffles require an infrastructure for offering coupons, organizing the drawing, and validating the winner. In small towns, prizewinners and prizes can be paraded through town to reach a larger audience and have a lasting impact on the community. A word of caution, raffles become less effective with repeated use. They may produce dramatic short-term results, but can be less effective than other techniques over the long term.

There are many ways for an MFI to promote its savings products. Each institution must evaluate the local market and its own resources to determine which mechanisms are most appropriate. A successful marketing program will combine various marketing tools. All advertising and promotions should be reviewed frequently to maintain their freshness and evaluate their effectiveness.

Client Relations

Microfinance institutions must provide high-quality service to attract savers. Client relations are critical to providing high-quality service. The client relations challenge involves establishing policies that define how the institution will deal with clients, developing a client-first attitude among all staff, sensitizing staff to client needs, and training staff to respond to clients.

Training

Staff training is essential to good client relations. It is important that staff members behave appropriately during all client contacts. First, staff members must be courteous and polite at all times. Second, they must be knowledgeable about the products and services offered by the institution. Third, they should know about marketing programs so they are prepared to answer questions. A lack of staff knowledge about services and programs can hurt the savings institution. In addition to training, staff members should have access to product and service information whenever they need it; the product manual provides this kind of information. Staff training should not be a one-time event, but a continuing process.

Distance Training. Training is expensive, especially if staff members are located throughout several offices. One practical approach to training scattered employees is distance training. Distance training can be accomplished by installing training materials on the institution's computer system. This type of training is relatively inexpensive, especially when compared to bringing all employees together for classes. Distance training enables the institution to have its entire staff take courses simultaneously.

A savings institution can use distance training to train its staff in procedures, products and services, and client service. Distance training has several advantages:

- It is uniform, which ensures that all staff receive consistent and accurate information.
- It can be administered to several employees in several offices of the institution at one time.
- It can be configured as a graduated series, taking employees through a series of steps, from the introductory level to an advanced level.
- It is inexpensive, does not require transporting employees or the use of special trainers, and is easy to produce, update, and distribute.

Computer training can be made available before and after office hours, or scheduled for slower times during the workday. The course has to have a narrow focus so the trainees can complete it in two to four hours (one hour per week for two to four weeks). This training strategy requires that the branch manager or a department supervisor act as training coordinator, scheduling staff training according to a master plan developed by the human resources department.

Using Computers to Improve Client Service

Savings institutions can install and use client relationship management (CRM) software to improve client service. In the beginning a simple database is sufficient. Staff members make notes in the computer database about client requests, needs, and status. They then use that information to offer products that best meet client needs. This process of information storage, retrieval, and use is called data mining. The data reside in a data warehouse, either in simple databases or in specialized programs, for staff to consult when serving clients. A good data warehouse contains detailed information about existing clients as well as about the potential client population, competitor institutions, and past marketing campaign responses.

The first step is to define what data will be required, then capture it systematically and store it for later access. Managers and marketing staff need to have a clear idea of the information they require to support the institution's long-range goals. What information is needed to retain clients and increase the institution's market share? Questions to be answered include:

- What information is needed to determine marketing and financial strategies?
- What information is needed to be more competitive?
- What does the institution need to know about its clients?
- What does the institution need to know about its competitors?
- Which marketing strategies are most effective?
- Which clients should the savings products target?

Effective data mining requires constant data collection and systemization. Staff members enter the information as they gather it. For instance, a loan application gives information about employer, income, size of household, and so on. The staff member can enter the information between meetings with clients. Both managers and staff should view data gathering as an ongoing process. For efficient data gathering to occur, the software should be programmed to tell the employee what information is missing. Employees should be trained to gather this data without being intrusive. Once the routine practice of data collection is established with the staff, collecting information is easy and automatic.

Data querying is the process of retrieving information from the data warehouse. Once the information is warehoused and reports have been designed, staff can make queries for marketing and sales. Query results can be exported to a computer spreadsheet program. This will facilitate analysis and manipulation of the information in search of links, trends, and other strategic elements.

The CRM software should act as a workflow tool, in addition to providing an information database. This means the system should display automatic reminders to staff members when they make contact with a client. The system should be able to tell employees what services the client may need based on the information collected about that person. It should also remind employees to collect the missing information about clients needed to complete their client profiles.

Community Relations

Particularly in the microfinance arena, the relationship between the institution and its clients is a life-long one. Current clients belong to a community from which the institution draws new clients. Most new clients go to financial institutions based on third-party referrals. As a result, new client growth will depend largely on how the institution is perceived in the community. In the case of a credit union, this perception is even more critical because members are both owners of the credit union and members of the community. Credit union members usually live in the community where the institution is located; in many cases, the credit union was created by the community itself to serve unmet demands for financial services. The same is true for other MFIs, although owners and stockholders may live outside of the community.

There are many ways that a savings institution can foster and strengthen community relations. Some imply direct costs, such as sponsorships of local sports teams or events. In other instances, the institution's executives or directors participate in community events. A savings institution must establish a stable, positive presence in the local market.

Define a Strategy to Penetrate the Market

Having evaluated existing savings products against the demands of the local market and developed new products as necessary, managers must define a strategy to market the savings products. Promotional strategies to attract these savings may be based on image, quality of service, rates of return, or direct marketing.

Promotion Based on Image

Institutions will have to draw from a broad market to build the level of deposits required to (1) provide savings services to low-income clients

Growing the savings base. There are four ways for an institution to grow its savings base:

1. **Attract new savers.**
2. **Persuade savers to put more money into their accounts.**
3. **Convince savers to use additional savings products.**
4. **Reduce the number of savings account closings.**

on a sustainable basis, and (2) fund a growing loan portfolio. In addition to targeting new savers and first-time savers, savings institutions have to attract net savers from other institutions. Promotions based on image (brand) are the least expensive and most efficient strategy to mobilize savings from both groups.

To compete in the savings market, an institution must project an image of professionalism, safety, and security. Many characteristics define a savings institution's public image, including: mission, vision, number of years in the market, past performance, quality of client relations, physical presence, size, existing client base, local market characteristics, and existing advertising presence. Institutions hoping to attract deposits should include the following elements in their marketing strategies:

- Appealing names;
- Modern logos or symbols;
- Well-trained, capable, and efficient staff;
- Standardized facilities and uniforms;
- A planned advertising effort to reinforce the brand; and
- Attractive facilities.

The appearance of a savings institution's physical structure is extremely important. The institution's building should be constructed with ample windows that allow for views of the surrounding setting and let in natural light. The facility should present a welcoming appearance to visitors. The building should present an attractive façade and have professional signage. Security measures, such as guards, should be clearly visible. Interior spaces should be clean and in good condition, presenting a solid, professional appearance. The service areas should make efficient use of space, particularly in smaller institutions, so that clients feel comfortable coming to the building.

Reinforcing the brand. Managers in a savings institution must consider the broader appeal of its name, logo, and physical presentation. An appealing brand is a great asset to an institution. A good brand conveys a sense of the core business, emphasizing the unique strengths of the institution.

Appealing names. In many countries, the names of credit unions and other MFIs are associated in some way with the original promoters, such as religious institutions or companies. If these institutions are open to the general public or if they will eventually be open to the public, such affiliated names can be counterproductive. For example, if a religious reference is used in naming an MFI, potential clients may think that only members of that particular faith can become clients. Company names, especially if the company is well known, can also be limiting in attracting new clients. Using geographical references in the name of an institution can interfere with future growth beyond the home region.

Attractive logos. An institution's brand—or reputation—is communicated by its logo. Older institutions often have traditional-looking logos and resist changing them. Outdated logos have several characteristics that discourage potential clients. These logos usually consist of a seal, a lot of text, and little color. This type of logo conveys a conservative attitude and behavior. It also connotes traditional values and systems. This may attract older clients, but discourage younger clients. Savings institutions should have logos that will be attractive to savers of all ages and income groups.

When branding an institution, focus groups should be used to identify names and logo designs that would be attractive to a wide range of potential clients. The savings institution will invest heavily to promote its brand in the local market. The continuous process of building a brand image means that it is important for the institution to choose an attractive name and logo at the outset, as a change may devalue the brand image. The criteria that apply to designing and branding products also apply to selecting a name and logo.

Uniformity of presence. Savings institutions may expand through branch offices as they grow and serve larger markets. To reinforce the image of professionalism, safety, and security, it is necessary to maintain a uniform appearance for all buildings. Branch offices should use the same name and signage on the building façade as the main office. Colors and interior design elements (such as teller windows, work surfaces, and office dividers) should be standardized. A uniform presence sends a clear message to clients and potential clients that they can expect consistent quality of service from various points of service.

The image acts as a launching platform for the institution's savings products. Savers want to feel that a professional and secure institution will care for their deposits. If an institution does not have an appealing and trustworthy image, it will have a difficult time attracting savers.

Promotion Based on Quality of Service

The best promotional strategy for savings mobilization is to associate the products with high-quality client service. When competition is based on service, clients become aware of and accustomed to high-quality service. They compare this level of service with that of other financial institutions where they may do business. The comparison reinforces the loyalty of clients of the most service-oriented institution. This reinforcement is continuous and builds over time, giving this marketing strategy a long-term effect. It also opens a wider gap between those institutions that offer high-quality service and those that do not. Clients who are satisfied with the service and treatment provided by the staff of the institution will not move their money for a small difference in interest rates. High-quality service generally includes three aspects: speed, response, and convenience.

Speed. Most savings products require clients to visit the institution frequently to make deposits and withdrawals. Clients want to spend as little time as possible transacting business. Good service saves clients time and effort. It also lowers the transaction costs to the institution. Long waits in lines, not enough tellers, excessive bureaucracy, and bad treatment by the staff are failings common to many financial institutions. If these inconveniences are not addressed and controlled, clients receive a low quality of service and are likely to avoid or stop saving in the institution.

Response. Clients are entitled to accurate responses to their questions and timely solutions to problems. Clients constantly need information, such as the balance of an account or the status of a loan application. Requests for information may be made in person or by telephone, e-mail, post, or fax. Regardless of how they communicate, clients expect complete replies in a reasonable amount of time.

Clients do not always expect immediate solutions to problems, but they do expect their financial institution to keep them informed during the resolution process. Information is an important component of providing high-quality service, yet many MFI managers delay giving clients information about a problem until it is resolved. If clients are not informed about the process of resolving problems, they may feel that the financial institution does not see their problems as serious matters. Research has shown that one of the principal client complaints about financial institutions is a lack of information sharing.

Convenience. Clients want to be able to access financial products in as many ways as possible, as quickly as possible. They want to be able to use the branch offices of an institution, especially if these branches are near homes and workplaces. ATMs and service windows in retail stores are service elements that facilitate client transactions. Savers want access to their deposits and MFIs must respond to this demand for convenience in order to attract savers.

When managers are confident that their savings institution offers speed, response, and convenience, they can market this high quality of service to distinguish their institutions and their savings products from the competition.

Promotion Based on Rates of Return

Another strategy for selling savings products is to promote the unique characteristics of the products. In most cases, interest rates are not the primary reason a client selects a particular savings institution. Generally, savers select an institution based on their assessment of the security and convenience offered. Nevertheless, many financial institutions try to compensate for a lack of soundness by offering high rates of return. Not only does this strategy increase the cost of using the funds deposited, but it may also undermine confidence in the institution. From experience, people know that failed financial institutions have usually paid excessive interest rates on savings. (The only way such institutions can survive for as long as they do is to increase liquidity. To attract the new funds in a short period of time, they must offer unrealistically attractive rates.) Managers should offer rates that are competitive in the market, but not unnecessarily high, which can make the difference between profit and loss.

Alternatively, clients making term deposits look for the best combination of rate, term, and liquidity. Such clients have little loyalty to the institution and may move their money to another institution for as little as a half-point more on the rate of return. As a result, interest rates are important in marketing fixed-term deposits.

Strategy related to rates-versus-terms competition is complex and expensive. It is difficult to implement because doing so depends on several conditions:

- The institution must stay up to date on daily market rates offered by banks and other financial institutions.
- The staff that handles fixed-term deposits must know how to negotiate in such a way to ensure that an attractive rate is paid, but that the rate is not too high relative to the amount and term. Well-trained financial officers are needed because rate-based negotiations are complex.
- The behavior of market rates must be taken into account constantly since the term of the deposit should be defined according to rate expectations. For example, if fixed-term deposit rates tend to rise, the savings institution sets longer terms to try to keep the cost of the money low. If market rates for fixed-term deposits are falling, the institution sets shorter terms to avoid paying higher costs for money than the market demands.

The costs of promoting fixed-term deposits based on interest rates can vary due to these factors. Rate-based promotions should not be used for passbook accounts and other demand products, since users of these products are more concerned with security and convenience than with rates of return.

Managers in a savings institution must select the most appropriate strategy for their specific conditions. The three strategies offer different benefits, and may be best used in combination. The marketing tools presented earlier in this chapter are employed as components of the larger strategy to penetrate the market. A savings institution must have a clear strategy in place to mobilize increased levels of savings.

Branching

One of the greatest limitations of financial institutions is the way funds must be deposited into savings accounts. There are no real substitutes for over-the-counter cash deposits and withdrawals. In some places, clients can deposit checks by mail, but in most countries checking accounts are limited and the mail service is inefficient. ATMs and deposit kiosks can facilitate deposits, but even where they are feasible, deposits are usually limited to checks because clients will not risk placing cash deposits in these machines. Savings institutions that want to expand their outreach do so through branching. Managers in a savings institution determine how many and what types of branches they need to cover a certain area on a cost-effective basis.

The objective of a branching strategy is to cover the widest geographical area possible. Different markets will require different levels of service. An effective and profitable branching strategy is to determine the type of clients and transactions that each branch will handle, and then open the appropriate type of branch that will satisfy the demands of the local market.

Branching can be as simple as setting up a window in a local market, or as complex as setting up a full-service regional office to which other branches report. The first step in branching is for managers to find out about the legal requirements in their country for establishing branch offices. The next step is to determine the size and set-up of the branch. Branching strategies consider geographical coverage, local demand, and institutional capacity. Branches can be categorized as follows:

- **First-level service window:** With one employee, this type of branch offers only teller transactions. It is usually found in local markets, department stores, and grocery stores. This may also be an extended-hours service window attached to a larger branch. The service window reports to a second-level service center, or to the home office.
- **Second-level service center:** This type of branch offers more services than the service window. Clients can make transactions, open accounts, apply for loans, and obtain

information about products and services. The service center has three employees: a teller, a loan officer, and a guard. The loan officer also handles information requests and opens accounts. This multi-purpose officer usually has the managerial authority in the branch. This type of branch can accept loan requests and approve small loans. It must send loan documents to the next branch level or to the main office for processing and it cannot approve large loans. The service center is usually about 50 square meters (450 square feet) in size. It reports to a third-level full-service branch.

- **Third-level full-service branch:** This type of branch is the smallest type of full-service branch. Typically, full-service branches use a minimum of 200 square meters (1,800 square feet) and at least five and a half employees: branch manager, teller, information and account opening officer, loan officer, guard, and a part-time maintenance employee. This branch may support a nearby service window or service center. The full-service branch reports to the fourth-level regional office.
- **Fourth-level regional office:** This type of branch offers full services to clients and manages the activities of first, second, and third-level branches within its geographic region. This office has between 12 and 20 employees, including a regional manager, several loan officers, tellers, and guards, and a full-time maintenance employee. The regional office reports to the main office.
- **Fifth-level main office:** The main office usually has the greatest number of employees. The main office provides full service to clients, manages the regional offices, and oversees activities in the lower-level branches. All other branch levels ultimately report to the main office.

Service windows should be more numerous than service centers, which should be more numerous than full-service branches. Regional offices are few, and there is only one main, or headquarters, office. In this way, geographical coverage is extended, and costs are kept under control. ATMs, deposit kiosks, and interactive kiosks that allow access to account information and payment options are also considered elements of branching.

Within one institution, there are savings mobilization-oriented branches and loan disbursement-oriented branches. Within the branching framework, the loan-oriented branches pay fees to the savings-oriented branches to have access to their funds, which are mobilized to make loans. The cost of the money paid by the loan-oriented branches is considered income for the savings-oriented branches.

Planning

Managers in a savings institution should have a vision for the future and a long-term development strategy to reach that vision. The long-term development strategy is broken down into short-term strategic actions that, through effective planning, work together to achieve the broader vision.

Long-term Planning

Planning for the future means managers must think about how the institution will adapt savings products in a continually changing environment. A long-term perspective can incorporate many variables and yield important insights:

- **Banking technology:** The tendency to migrate to plastic money (using a magnetic strip or an "intelligent" chip) is inevitable. Every year an increasing number of financial transactions take place in the home or workplace.
- **Access to a global banking network:** Financial institutions are becoming global. Globalization implies that international standards must be considered and introduced along with new products (for example, BIN in debit and credit cards, ABA routing numbers, and three-digit verification in debit and credit cards).
- **Development phases:** Long-term planning requires phased strategies. Each long-term strategy should be broken into manageable phases. Results should be measured on a regular basis, with established performance targets.

Projecting the long-term evolution of the financial market is closely related to new product development, since changing patterns of collective behavior affect how new products are received in the market. Research conducted on national financial market behavior will help managers to better understand market trends.

Short-term Planning

On a short-term basis, planning efforts must consider: existing infrastructure and organizational development, financial resources for investment in infrastructure, and product adjustment and evolution.

Existing infrastructure and organizational development. The planning process must consider the infrastructure needed to manage savings products and services. This includes physical facilities, technology, and human resources, all combined to produce optimal performance. As markets evolve, the organization must adapt to ensure its continued stability and profitability.

Financial resources for investment in infrastructure. Changing times and evolving markets require investment in new infrastructure. When the time comes to invest, resources must be available. The healthiest way to provide for future investment in infrastructure is to create reserves. When the provisions for infrastructure investments are taken as expenses, the cost of delivering the financial products remains unaffected.

Product adjustment and evolution. Products under development and existing products must be evaluated continuously to determine if they are affected by changing market conditions. Products should (1) address client demands, and (2) maintain the profitability of the institution. Based on the results of this constant evaluation, adjustments should be made throughout the product life cycle to keep products attractive.

All short-term planning should be considered within the framework of the institution's long-term development plan. Coordination of short-term strategies and long-term strategies helps to avoid costly mistakes or redundancies.

Marketing Planning

When planning for marketing programs, managers should keep in mind their long-term strategic plan for the institution. The strategic plan sets the goals for the organization; marketing is a vehicle for meeting those goals. There are three steps to marketing planning: goal setting, budgeting, and follow-up and control.

Goal-setting. Goal-setting for savings mobilization begins by analyzing past activity (at least three years) of each savings product. This allows the institution to project realistic goals for the coming year. Projections should include seasonal fluctuations. The savings institution can expect its savings portfolio to increase or decrease depending on the rates it offers. Business planning software allows the institution to experiment with various combinations of rates, income, and expenses to create an annual plan. Growth targets should take into account the anticipated increase in savings mobilized as a result of marketing efforts, such as promotions, new product launches, sales, and cross sales.

Once managers have defined the goals and business plan for the year, they can work with the marketing department to develop an annual marketing plan. The marketing plan should be broken down into detailed activities. Each activity should be listed with the information about who is responsible for implementation, when it should occur, and what the deliverable or outcome should be.

Budgeting. The first step in budgeting is to define the cost of each activity included in the marketing plan. Budgeting will help managers to determine if the marketing plan is feasible. If the plan is not financially feasible, managers should reorganize activities and priorities until they devise an achievable marketing plan. A strict monthly accounting of marketing costs and benefits should be kept to monitor implementation of the plan.

An important aspect of the budgeting process is cost reduction. If the savings institution cannot afford to carry out its entire marketing plan, managers should eliminate certain activities rather than cut the budgets of all activities. Severe cost reductions can lead to ineffective marketing activities with poor results. It is better to fully fund some activities and eliminate others or defer them to the following year, so that the activities implemented are effective. Managers should work with the marketing department to evaluate the effects of cutting marketing activities from the budget.

Follow-up and control. The effectiveness of a marketing plan must be measured regularly to determine (1) if the activities are being implemented, and (2) what the savings institution has gained in the way of additional sales, savings, or new clients. In other words, managers need to evaluate how the marketing plan helps the institution reach its strategic goals. If the marketing plan is not meeting its goals or furthering the strategic goals of the institution, managers must work with the marketing department to assess the reasons for this and adjust the marketing plan as appropriate.

Profitability Planning

All products must be profitable in a self-sustaining institution, even those that target the poorest economic sectors. Each product adds to or deducts from the financial health of the institution. Readers should keep in mind that no new financial product is immediately profitable. Each new product requires time to reach a break-even point for two reasons:

1. The product must achieve a profitable volume of accounts or level of operations; and
2. It must recoup the cost of launching it.

Developing a break-even model. There are two ways to determine the financial results related to savings mobilization and lending portfolio growth:

1. Calculate the break-even point. Determine the fixed costs, define the financial costs and income, and then determine

Breaking even on youth savings. Youth savings presents the most extreme case of time required to reach the break-even point. Youth accounts usually have low balances, pay low interest rates, and have few transactions. The margins on these accounts are very small. However, when the owner of the account reaches the legal age of client status (usually 18 years old), he or she may transfer the account into another product that does generate income for the institution. In this case, the product may have taken 20 years to reach the break-even point, but it does become profitable. Meanwhile, maintaining the product has engendered brand loyalty in the account holder and maybe in his or her parents. It may also create new business in other areas if the client, now an adult, uses additional products and services offered by the institution.

the level of activity required to reach the break-even point at anticipated rates. Subtract the actual portfolio from the required portfolio balance. The difference will provide the short-term targets for savings mobilization and lending.

2. Analyze the profit and loss for a given level of the portfolio's balance, for both savings mobilization and lending. This method of analysis will yield the approximate break-even point.

Developing a break-even point model is essential to understand what the numbers reflect and to arrive at achievable goals for both savings and lending.

Measuring Profitability. There are two ways to measure profitability:

1. Prepare a statement of balances on hand (such as issuing a financial statement), or
2. Prepare an analysis of profit or loss (time series analysis).

The time series analysis will provide a better analysis than a statement of balances on hand as to whether a product breaks even. The eventual profit or loss will depend on the volume of accounts, loans, or operations growth over time. A time series analysis enables managers to determine when the product will reach the break-even point. With this information, managers can set achievable targets in their short-term strategies and maintain realistic goals over the long term.

Managing Growth

As a financial institution grows, its quality of service will decline unless the institution focuses on maintaining the level of quality through staff training and use of technology. Financial institutions must grow to produce significant profit. Managing this growth will depend on the efficient use of the installed capacity.

A simple example clarifies the issue: An employee in a financial institution waits on clients and the public in a new branch. Over the course of several months, perhaps years, the employee will serve a growing number of clients. Waiting on clients will progressively occupy more of the employee's time. Initially, the employee may have to attend to other tasks, but the time devoted to these other tasks will diminish as the employee devotes himself or herself to the main task of attending to client needs. The employee's capacity is reached when he or she has to handle the maximum number of clients possible without making those clients wait an excessive amount of time. If no other employees are hired to serve clients, the quality of service will decrease, no matter how much effort the employee makes. Client waiting time will increase, and unconsciously the employee will try to accelerate interactions with clients to cope with the mounting pressure. The installed capacity, in this case the employee, is less expensive to maintain because it has reached its limit. If another employee is hired, the cost of both employees for every client contact will rise because two are now doing the same work that was done by the first employee. Each employee is working at half his or her capacity, but both are receiving a full salary. Initially, there are not enough clients to occupy both employees full time, so the cycle begins again. Other tasks are assigned to both employees to fill their working hours.

Traditionally, financial institutions have coped with this issue by waiting for the workload to exceed the limits of their workers' capacity before hiring new staff. Waiting to hire more staff is a risk, however, because the point at which the quality of service begins to deteriorate is not always clear. Another way to cope with the problem is to be flexible in the use of staff time. Other employees whose main job is not attending to clients can serve as a reserve during peak business hours. The administrative work normally done by these employees can wait; savers cannot and will not wait. The issue is how to manage the situation created by the limits of installed capacity without diminishing client service.

Financial institutions can maintain high-quality client service while growing in several ways:

- Automating information management and other processes;
- Training staff to spend less time transacting business (staff should be trained to keep contact time to a minimum);
- Continually training staff members in client relations, and training them to be friendly and courteous at all times;
- Determining the maximum workload that each employee can handle before quality of service is affected (this maintains the optimal cost of each employee for the longest possible time); and
- Finding the balance between marginal costs and future growth provisions, in terms of equipment and installations.

If an institution mounts an effective savings mobilization program with innovative products and effective marketing, it will increase the number of clients and the volume of funds coming in and going out. Maintaining high-quality service will be challenging, but it is essential to continued growth in savings.

Conclusion

Good product offerings and effective marketing are the cornerstones of a successful savings mobilization program. While it is necessary, it is no longer sufficient for institutions to present an image of trustworthiness and security to attract savings. Once they establish solid brands (reputations), MFIs must offer the products and services that clients demand in order to attract their savings.

The first step in product development is to evaluate existing products. Managers in a savings institution must ask themselves if their products address client demands. The product life cycle model—launch, growth, maturity, and decay—is a useful framework for evaluating existing products. Each phase of the model has particular strategies that can be applied to lengthen the life of the product. Various sources of information can be used to evaluate existing products. They include client complaints, staff observations, market research, competitor activities, and national financial market behavior.

If managers determine that the existing savings products do not meet client demands, then they should initiate the new product development process. New product development requires market research to determine if there is sufficient demand to support the product; designing and testing of a new concept to refine the product; and promoting the new product.

Products must be well managed. The basis for effective product management is the product manual. The product manual maintains detailed information in a standardized format about every product or service offered by the institution. Each section of the manual should include a general description and a detailed description of the product. The detailed description should include information on contracts and rules; forms, processes, and procedures; packaging; marketing and promotion; and profit and loss simulation models.

Marketing is the next step. The essential marketing tools include sales and cross-selling, selling in the field, media advertising, point-of-sale advertising, direct marketing and promotions. Each institution must evaluate the local market and its own resources to determine which marketing tools and strategies will be most effective.

Different promotional strategies may be employed to penetrate the local market. Savings institutions may decide to promote their products and services based on image, product differentiation, or quality of service. The three strategies offer different strengths; managers may implement them in some combination. A focus on good client relations provides a foundation for other marketing strategies. Staff training and use of client relations management (CRM) systems promote high-quality client services.

Institutions can cover a large geographic area in a cost-effective manner through using branches. There are five levels of branches: service windows, service centers, full-service branches, regional offices, and the main office. Each branch provides a different level of service, depending on the demands of the local market. Branching strategies should consider geographical coverage, local demand, and institutional capacity.

Effective planning enables managers to fit marketing and savings mobilization programs within the broader goals of the institution. Long-term planning provides the overarching vision of the institution. Short-term planning considers existing infrastructure and organizational development; financial resources for investment; and product adjustment and evolution. Marketing planning, which includes goal setting, budgeting, and follow-up, supports the short-term and long-term goals of the institution. Profitability should be considered in all levels of planning. As the savings program grows, managers will need to actively manage the growth of the institution to ensure that the quality of service is not compromised.

Savings product development and marketing is a continuous process in a financial institution. An institution should have a core group of products that meet basic savings demands of the local market. In order for an institution to remain competitive, it must constantly evaluate these products to ensure that they continue to meet the demands of an evolving financial marketplace. All savings products—existing and new—should be marketed using well-developed tools and according to well-defined promotional strategies.

CHAPTER 5 Counting the Costs of Savings Mobilization

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Much interest and debate have been generated in the microfinance industry during recent years regarding the feasibility of providing savings services to poor and low-income clients. The debate started when a few practitioners expressed reservations about the economic sense of mobilizing savings deposits to finance the burgeoning microenterprise loan portfolios of mainstream microfinance institutions (MFIs).

On the skeptics' side of the debate is the belief that savings mobilization will only elevate already high operating costs and render institutions less competitive in an increasingly crowded microfinance marketplace. Many of the leading MFIs reject the possibility of microsavings mobilization (savings deposits of less than $300) because they see no economies of scale in providing the service, despite the high demand for savings services in the microfinance market. As competitive pressures force MFIs to reduce their operating costs, savings mobilization is viewed with increasing skepticism.

The other side of the debate points out that credit unions around the world have consistently provided microsavings services to their members on a sustainable basis. By providing services to members of diverse income groups, credit unions have tapped into savings deposits as a relatively stable, low-cost source of funds to finance growing loan portfolios. In just one example, 25 credit unions in Bolivia had 380,000 member savings accounts with an average balance of $38 at year-end 2001. Despite the small savings balances, those credit unions had an average administrative expense ratio of less than 10 percent of average assets.

This chapter presents a model for determining the costs of savings mobilization. It offers evidence from 15 credit unions in four Latin American countries to demonstrate that savings mobilization is not only essential to providing the poor with a broader range of financial services, but also that it provides a cost-effective source of funds for the institution. Lastly, the chapter offers ten tips on designing and implementing cost-effective savings programs.

Methodology for Costing

There are many ways to calculate and allocate costs among different products and services. For example, *functional costing* models require precise measurement of time requirements for each step of every function. *Allocation-based* models use quantitative and qualitative measures to allocate costs to the different products offered by an institution in order to arrive at total costs. *Activity-based* costing matches costs with specific activities undertaken by the institution, such as opening a savings account or processing a loan. The methodology presented in this chapter draws from these approaches and attempts to orient readers to the most important areas that should be analyzed when determining the costs of savings mobilization. There are three main areas of outlays to consider when evaluating the total operating costs of a savings mobilization program: financial costs, direct administrative costs, and indirect administrative costs. In the final analysis, it will be up to readers to determine which specific line items are relevant for their own savings institutions.

Financial Costs

Financial costs are mainly the price an institution pays clients to persuade them to deposit their savings. These costs relate directly to the volume of savings mobilized. Financial costs include interest, insurance, taxes, and dividends.

Interest. This is the amount of interest paid to depositors. Interest costs are calculated by multiplying the average balance of the savings account by the simple interest rate for the number of days that deposits are in the account.

Insurance. This is the cost of a life insurance premium calculated on the monthly balance of deposits. Insurance is paid to the family of the deceased, depending upon the age and the savings balance of the client at the time of death. This cost is included only if it is paid by the savings institution. If insurance is subtracted from the interest payable to the depositor (or from the gross dividends paid to members in credit unions), it is not included in financial costs.

Taxes. This is the cost of sales and other taxes levied against the interest paid on savings deposits. This cost is included in the calculation only if it is paid by the savings institution. If it is deducted from the interest payable to the depositor, it is not included.

Dividends. In the case of credit unions, dividends on member shares are treated as a financial cost.

The sum of the interest, insurance, taxes, and dividends is divided by the average balance of total deposits and shares to determine the financial costs. The average balance of total deposits and shares is calculated by adding the beginning balance to the ending balance and dividing the sum by two. Depicted as a ratio, financial costs are:

$$\frac{\text{Interest} + \text{Insurance} + \text{Taxes} + \text{Dividends}}{\text{Average balance of total deposits and shares}}$$

Direct Administrative Costs

In this study, we use a definition of direct administrative costs that is different than the one used in traditional cost accounting literature. We refer to direct administrative costs are those costs that are incurred as a result of engaging in savings mobilization. Institutions that do not mobilize savings would typically not incur these costs. By using this definition, however, we do not mean that 100 percent of all direct costs must be allocated to savings-related activities. As shown in the tables that follow, a percentage of direct administrative costs is allocated to non-savings activities, such as the marketing of credit products. (Even though the marketing function may have begun as a result of savings mobilization, it was expanded to include the marketing of both savings and credit products because of the obvious economies of scale.) Our study identified three main areas of direct administrative costs: human resources, marketing, and commissions.

Table 5.1 Human Resource Costs Related to Savings Mobilization

Position	Salary	Benefits			
		Severance[1]	Christmas Bonus[2]	14th Bonus[3]	Vacation Bonus[4]
Direct Administrative Costs					
Marketing Area					
Director of Marketing	796	74	64	64	51
Marketing Technician	503	46	37	37	30
Receptionist	375	33	26	26	21
Tellers					
Head Teller	503	46	37	37	30
Teller	433	39	31	31	25
Teller	378	34	27	27	21
Security					
Security Guard	306	27	21	21	17
Security Guard	185	15	11	11	8
Indirect Administrative Costs					
Management					
General Manager	1,567	149	128	128	102
Assistant Manager	936	88	75	75	60
Regional Office Manager	0	0	0	0	0
Branch Office Manager	631	58	48	48	38
Credit and Finance					
Director of Finance	796	74	64	64	51
Director of Credit	516	47	38	38	31
Director of Collections	641	59	49	49	39
Loan Analyst	350	31	24	24	20
Loan Collector	248	21	16	16	13
Back Office Group					
Internal Auditor	841	79	67	67	54
Chief Accountant	541	50	40	40	32
Administrative Director	503	46	37	37	30
Administrative Assistant	503	46	37	37	30
Director of MIS	516	47	38	38	31
Assistant Internal Auditor	210	17	13	13	10
Auxiliary Accountant	248	21	16	16	13
Computer Technician	366	33	26	26	21
Support Services					
Janitors	293	25	20	20	16
Messengers	317	28	22	22	17
Total	**13,504**	**1,232**	**1,012**	**1,012**	**809**

All numbers are rounded to nearest whole in U.S. dollars.
See footnotes to this table on page 160.

Benefits				Monthly	
Economic Benefit[5]	Retirement Fund[6]	Social Security[7]	Benefits Subtotal	Salary & Benefits	Annual Cost
22	38	60	373	1,169	14,030
14	22	37	223	726	8,712
10	16	27	160	535	6,414
14	22	37	223	726	8,712
12	19	31	189	622	7,461
10	16	27	162	540	6,483
8	12	21	126	432	5,186
4	6	12	67	252	3,025
45	77	120	749	2,316	27,792
26	45	71	441	1,378	16,532
0	0	0	0	0	0
17	29	47	285	916	10,987
22	38	60	373	1,169	14,030
14	23	38	229	745	8,939
18	29	48	290	931	11,169
9	15	25	148	499	5,982
6	10	17	98	347	4,163
24	40	63	395	1,236	14,826
15	24	40	241	783	9,394
14	22	37	223	726	8,712
14	22	37	223	726	8,712
14	23	38	229	745	8,939
5	8	14	80	290	3,480
6	10	17	98	347	4,163
10	15	26	156	522	6,267
8	12	20	120	413	4,959
8	13	22	132	449	5,391
370	607	993	6,034	19,538	234,460

Table 5.1 Footnotes

[1] *Benefit paid to employees when they resign or are fired, equivalent to one pay check for every year worked plus the Christmas and 14th bonuses.*

[2] *A bonus paid to all employees at Christmas, equivalent to one paycheck.*

[3] *A bonus paid to all employees in the month of July, equivalent to one paycheck.*

[4] *A bonus paid to all employees when they take vacations, equivalent to 80 percent of one paycheck.*

[5] *This is a complement to the severance that an employee receives when leaving the organization, equivalent to 30 percent of the severance.*

[6] *This is an employer contribution to a retirement fund that all employees of credit unions share. The contribution in this credit union is 5 percent.*

[7] *Social security contribution of 7.83 percent of salary, paid by the credit union.*

Human resources. Three groups of employees have responsibilities that relate directly to savings mobilization: marketing staff, tellers, and security guards.

The monthly or bimonthly payroll is the best source of information for calculating the personnel costs for these three groups. In addition to the base level salaries, it is necessary to include all of the fringe benefits paid to the employees. Some examples of these benefits would be health insurance, retirement benefits, and incentive bonuses. These fringe benefits can represent as much as 60 percent of the base salary and so constitute a significant part of the costs. Table 5.1 shows how one credit union calculates total human resource costs, including salaries and benefits.

Marketing Activities. Three principal activities are associated with the successful marketing of savings products: publicity, promotional activities, and feasibility studies. They all incur direct administrative costs.

- **Publicity:** The most common forms of savings publicity are advertisements in newspapers, magazines, television, radio, and on billboards. This type of publicity carries significant costs.
- **Promotional activities:** The most popular promotional activities are raffles and lotteries. The costs include the prizes and printed materials.
- **Feasibility studies:** The costs of evaluating the market potential of new services and products are incurred in the process of deciding to begin or expand a savings program.

Commissions. Commissions are incentives paid to employees for bringing in new savings accounts. These costs are in addition to base salaries and benefits.

Indirect Administrative Costs

The most challenging part of the costing process is accounting for the indirect administrative costs related to savings mobilization. We define indirect administrative costs as those costs that are incurred regardless of whether an institution raises savings or borrows from external creditors. Since indirect costs are a common component of all financial products and services, the challenge is to properly allocate those costs to the products—whether credit, savings, or insurance. In any case, costs must be allocated to the correct accounts according to criteria that are objective and defensible. We group indirect administrative costs into four areas: human resources, administrative services, depreciation, and protection.

Human resources. During our research in the 15 credit unions, we were repeatedly surprised by the large number of other employees—in addition to the marketing staff, tellers, and security—who were involved in mobilizing savings. We identified up to 18 positions in four categories that were involved with savings activities. While the number of employees varied from one institution to another, we found that most credit unions expected all of their employees to bring in new savers and attract a predetermined volume of new savings. These "non-savings" personnel were employed in management, credit and finance, back office, and support services. Table 5.1 breaks out the specific positions identified as part of indirect administrative costs. The percentage of employee time invested in savings-oriented activities is calculated later in the discussion of time-based allocation.

Administrative services. The second group of costs relates to an institution's daily operations. These services support all activities of the institution, including savings mobilization:

- Electricity, gas, water, and garbage removal;
- Telecommunications;
- Office maintenance;
- MIS support;

- Materials and supplies;
- Vehicle maintenance; and
- Vehicle mileage.

Depreciation. The cost of depreciation has taken on greater importance in recent years, as the costs of technology have risen. Shorter amortization periods have also contributed to higher costs. Depreciation can be broken down into five areas:

- Buildings;
- Vehicles;
- Office furniture;
- Computerization; and
- Leasehold interests (cost of remodeling rented facilities).

Protection. The fourth group of costs relates to the activities that ensure institutional safety and soundness. These include:

- Insurance premiums (property, robbery, theft, and general liability);
- External audit and supervision fees; and
- Certification and rating quotas.

Indirect Costing Methodology

In the development of our costing methodology, we considered several ways to allocate the indirect costs to their respective activities. Of the 15 credit unions analyzed, none had developed a method for allocating indirect costs. In each case, the managers were focused on generating sufficient net income to cover operating costs. In that light, the method that we developed to allocate indirect costs is not a "best practice" of the credit unions; rather it is a way to categorize administrative costs to give readers a realistic idea of what it really costs to mobilize savings. We eliminated as many subjective criteria as possible and focused on verifiable, quantitative data. We simplified the criteria so that managers would be able to calculate their own costs without using sophisticated database management systems.

We identified three ways to allocate the indirect costs among departments: transaction-based, physical space-based, and time-based.

These methods form the framework for the data that is presented on the costs of mobilizing savings in the 15 credit unions.

Transaction-based Allocation

We used the transaction-based method to allocate costs related to the volume of savings transactions in a year. We tabulated the total number of transactions as well as the number of transactions related to savings activities (deposits and withdrawals) for each credit union. We used these numbers to calculate the percentage of savings-related transactions. We could then allocate the indirect costs appropriately. Indirect costs allocated by transactions include supplies, insurance for robbery, computer maintenance, and depreciation. Table 5.2 shows how to calculate the indirect cost factor of savings mobilization using the number of teller transactions.

Table 5.2 Total Teller Transactions—Sample Credit Union

Description	Number	Subtotal	% of Total Transactions
Savings		143,598	63.65
Deposits	64,912		
Withdrawals	57,489		
Open accounts	7,340		
Close accounts	6,032		
Transfers	4,578		
Replace passbooks and other	3,247		
Loans		71,871	31.86
Disbursements	4,286		
Payments	51,411		
Others	16,174		
Other		10,146	4.50
Debitor and creditor payments	2,211		
Insurance	7,935		
Total of transactions		225,615	100.00

Physical Space-based Allocation

We employed the physical space-based method to allocate indirect administrative costs related to physical space usage. We calculated the percentage of physical space dedicated to savings mobilization by determining the actual square footage used for savings services and dividing that by the total square footage of the credit union. Expenses such as telephone, electricity, gas, water, janitorial services, office maintenance, and depreciation were allocated in this way. Table 5.3 shows how to calculate the indirect cost factor of savings mobilization using the physical space-based method.

Table 5.3 Determination of Physical Space Dedicated to Savings Mobilization (Square Meters)

Formula:	1	2	3	4 = (1+2+3)	5	6 = (4+5)
Branch	Lobby	Tellers	Marketing	Subtotal Related to Savings	Other Areas	Total of Space
Main office	50	30	25	**105**	675	**780**
02	21	13	13	**47**	25	**72**
03	22	12	10	**44**	18	62
04	29	9	7	**45**	22	**67**
05	23	12	11	**46**	50	**96**
06	15	9	13	**37**	196	**233**
07	8	7	11	**26**	58	**84**
08	0	10	0	**10**	22	32
09	32	16	6	**54**	104	**158**
10	18	5	9	31	25	**56**
11	8	10	9	**26**	30	**56**
Physical Space by Department	224	134	113	471	1,225	1,696
Percent by Department	13.2	7.9	6.7	27.8	72.2	100.0

Time-based Allocation

We used the time-based method to allocate the personnel costs of the employees who were indirectly or partly involved in savings-related activities. We asked each employee to estimate the percentage of time that he or she spent on savings activities. Even though this method was subjective, we considered it the best way to allocate the part-time labor of such a large group of employees. Table 5.4 illustrates how one credit union identified all of the employees involved in savings mobilization, their total compensation, and the percentage of time spent on savings-related activities. This information forms the basis for allocating the human resource costs associated with savings mobilization.

We also used the time-based allocation method for certain costs in the administrative and protection services areas. Examples of time-based allocations in these areas include vehicle operating expenses, maintenance and depreciation, external audit and supervision, and rating and certification quotas.

Summary of Total Costs

The final step in this costing methodology is to total the costs in each area—financial costs, direct administrative costs, and indirect administrative costs—and relate that total to the average volume of savings deposits. In the case of credit unions, member shares are also added to the volume of savings deposits to arrive at the average total volume of funds mobilized, since similar resources are utilized in collecting shares from members.

Once we have determined each area of cost, and linked each area to the volume of funds mobilized, we can summarize the individual costs related to savings and determine the total costs of savings mobilization. Table 5.5 shows the costing methodology in use. The first column lists the cost element and the individual line items for all of the costs related to savings mobilization. The second column lists the allocation criteria used for each line item. The third column shows the total operating costs for the credit union. The fourth column shows the allocation factor percent used for each line item. The fifth column shows the operating costs associated with savings mobilization. The last column shows the cost of each line item as a percentage of the average amount of total funds mobilized.

Table 5.4 Time Dedicated to Savings Activities by Position

Formula:	1	2	3 = (2/1)
		Compensation	
Position	Number of Persons	Total Compensation	Average of Compensation
Direct administrative costs			
Marketing			
Directors of marketing	1	14,030	14,030
Marketing technicians	9	43,377	4,820
Receptionists	8	37,576	4,697
Tellers			
Head tellers	1	8,712	8,712
Tellers	22	105,041	4,775
Security			
Security guards	15	56,933	3,796
Indirect administrative costs			
Management			
General managers	1	27,792	27,792
Assistant managers	2	33,065	16,533
Regional office managers	0	0	0
Branch office managers	10	92,919	9,292
Credit and finance			
Directors of finance	1	14,030	14,030
Directors of credit	1	8,939	8,939
Directors of collections	1	11,169	11,169
Loan analysts	4	21,381	5,345
Loan collectors	2	7,870	3,935
Back office group			
Internal auditors	1	14,826	14,826
Chief accountants	1	9,394	9,394
Administrative directors	0	0	0
Administrative assistants	3	25,339	8,446
Directors of MIS	1	8,939	8,939
Assistant internal auditors	0	0	0
Auxiliary accountants	3	13,624	4,541
Computer technicians	2	12,533	6,267
Support services			
Janitors and messengers	13	43,174	3,321
Total	102	610,663	5,987

All costs are rounded to nearest whole in U.S. dollars.

4	5	6	7 = (2x4)	8
Time Dedicated to Savings Activities				
Weighted Average %	Minimum %	Maximum %	Cost by Position	Cost by Group
				64,786
90	90	90	12,627	
86	40	90	37,129	
40	40	40	15,030	
				85,315
75	75	75	6,534	
75	75	75	78,781	
				42,700
75	75	75	42,700	
				38,607
10	10	10	2,779	
10	10	10	3,307	
			0	
35	35	35	32,522	
				7,940
30	30	30	4,209	
5	5	5	447	
5	5	5	558	
7	5	20	1,591	
14	5	25	1,135	
				12,578
10	10	10	1,483	
25	25	25	2,349	
			0	
7	5	10	1,703	
25	25	25	2,235	
			0	
12	5	25	1,676	
25	25	25	3,133	
				4,317
10	10	10	4,317	
			256,243	256,243

Table 5.5 Summary of Total Operating Costs Related to Savings Mobilization

Cost Elements	Allocation Criteria
Average savings volume	
I. Financial costs	
Interest	Interest paid
Insurance	Insurance paid
Taxes on interest	Taxes paid
Shares dividends	Dividends paid
II. Direct administrative costs	
A. Human resources	
Marketing	% of time dedicated to savings activities
Tellers	% of time dedicated to savings activities
Security	% of time dedicated to savings activities
B. Marketing	
Advertising	Real costs of advertising
Promotion	Real costs of savings promotions
Studies	Real costs of market studies
C. Commissions	Commissions paid on new savings
III. Indirect administrative costs	
A. Human resources	
Management	% of time dedicated to savings activities
Back office and credit and finance	% of time dedicated to savings activities
Services support	% of time dedicated to savings activities
B. Administrative services	
Electricity, water, garbage removal	% of physical space occupied
Telecommunications	% of physical space occupied
Office maintenance	% of physical space occupied
MIS support	Transactions
Materials and supplies	Transactions
Vehicle mileage	% of time use of vehicles
Vehicle maintenance	% of time use of vehicles
Taxes	% of physical space occupied
C. Depreciation	
Buildings	% of physical space occupied
Vehicles	% of time use of vehicles
Office furniture	% of physical space occupied
Computerization	Transactions
Office rent	% of physical space occupied
D. Protection	
Robbery and general liability insurance premiums	Transactions
External audit and supervision fees	% of time of auditors and inspectors dedicated to savings
Property insurance premiums	% of physical space occupied
Provision cash shortfalls	Transactions
Total operating costs	

All costs are rounded to nearest whole in U.S. dollars.

Total Operating Costs	Allocation Factor %	Operating Costs of Savings Mobilization	%
		12,090,819	
		1,132,174	9.36
1,073,642	100.00	1,073,642	8.88
58,532	100.00	58,532	0.48
0	100.00	0	0.00
0	100.00	0	0.00
		249,812	2.07
		192,801	1.59
94,983	68.21	64,786	0.54
113,753	75.00	85,315	0.71
56,933	75.00	42,700	0.35
		41,553	0.34
18,513	100.00	18,513	0.15
23,040	100.00	23,040	0.19
0	100.00	0	0.00
15,458	100.00	15,458	0.13
		209,972	1.74
		63,443	0.52
153,776	25.11	38,607	0.32
148,044	13.86	20,519	0.17
43,174	10.00	4,317	0.04
		56,261	0.47
13,874	27.80	3,857	0.03
33,788	27.80	9,393	0.08
23,230	27.80	6,458	0.05
20,306	63.65	12,925	0.11
25,761	63.65	16,397	0.14
16,223	30.00	4,867	0.04
7,883	30.00	2,365	0.02
0	27.80	0	0.00
		73,285	0.61
22,496	27.80	6,254	0.05
8,750	30.00	2,625	0.02
47,892	27.80	13,314	0.11
73,208	63.65	46,597	0.39
16,169	27.80	4,495	0.04
		16,982	0.14
11,630	63.65	7,402	0.06
31,933	30.00	9,580	0.08
0	27.80	0	0.00
0	63.65	0	0.00
2,152,991		1,591,958	13.17

Table 5.6 summarizes the total operating costs calculated in Table 5.5. The percentages in the far right column of Table 5.6 are calculated by dividing the amount of each line item by the average savings volume. For example, the total financial costs of $1,132,174 divided by the average savings volume of $12,090,819 equals 9.36 percent (1,132,174 / 12,090,819 = .0936). Table 5.6 shows that the financial costs were the highest, followed by direct administrative costs, and indirect administrative costs. The total costs of savings mobilization were equal to 13.17 percent of the average savings volume.

Table 5.6 Summary of Total Operating Costs

Cost Area	Amount	%
Total Financial Costs	1,132,174	9.36
Total Direct Administrative Costs	249,812	2.07
Total Indirect Administrative Costs	209,972	1.74
Total Operating Costs	**1,591,958**	**13.17**
Average Savings Volume	12,090,819	

All costs are rounded to nearest whole in U.S. dollars.

Savings Cost Data of 15 Credit Unions

The objective of our study was to gather a representative cross sample of savings cost data from different types of credit unions throughout Latin America. We selected 15 credit unions from Bolivia, Ecuador, Guatemala, and Nicaragua. Three main criteria were used to select the sample credit unions: savings volume, experience with savings mobilization, and geographical location.

Savings volume. It was important to have a cross-section of large, medium, and small credit unions in order to see if there were significant economies of scale and cost savings for larger credit unions. *Large* was defined as having a savings volume greater than $5 million. *Medium* was defined as having a savings volume of $1 to 5 million, and *small* was defined as having a savings volume below $1 million. The study included six large credit unions, four medium credit unions, and five small credit unions.

Experience with savings mobilization. Credit unions with varying levels of experience were included in the study to see what impact, if any, experience in mobilizing savings had on costs. We found a direct correlation between experience and volume: the greater the experience, the greater the volume of savings. *Beginners* were defined as having less than three years of experience in mobilizing savings, *intermediates* had been mobilizing savings for three to ten years, and *advanced* for more than ten years. The study included four beginners, four intermediates, and seven advanced credit unions.

Geographical location. Although savings volume and years of experience were the most important criteria, we tried to include both urban and rural credit unions to see if geographical location affected costs. *Urban* was defined as an area with a population greater than 100,000 people and *rural* was defined as having less than 100,000 people. The study included four urban and 11 rural credit unions.

Results of the Study

Two seminal questions provided the foundation for the study:

1. Is savings mobilization a viable alternative to borrowing from external credit sources in order to fund loan portfolios?
2. Is microsavings mobilization feasible?

We found that the financial costs varied greatly from one country to another. Inflation, currency devaluation rates, and differing levels in the supply and demand for financial services affected financial costs. The financial costs were highest in Nicaragua at 17 percent, 16 percent in Bolivia, 9 percent in Guatemala, and 5 percent in Ecuador.

To answer the first question, we set aside the financial costs component and focused on the direct and indirect administrative costs associated with savings mobilization. This focus should enable readers to determine the financial costs in their own countries, calculate the administrative costs in their own institutions, and add them together to determine the feasibility of raising savings versus borrowing from external credit sources to fund their loan portfolios. One hidden cost of external credit not accounted for in our study, but that should be noted here and taken into account when calculating costs, was the high cost of reporting requirements imposed by donors on their beneficiaries.

We simplified the presentation of the direct and indirect administrative costs by reporting only seven main areas.

Under direct administrative costs, we studied:

- Human resources ("savings" personnel);
- Marketing; and
- Commissions.

Under indirect administrative costs, we studied:

- Human resources ("non-savings" personnel);
- Administrative services;
- Depreciation; and
- Protection.

Table 5.7 summarizes the direct and indirect administrative costs for the 15 credit unions in the study. The cost of each area is divided by the average savings volume to find the corresponding cost as a percentage. For example, when the total direct administrative cost of $1,315,651 is divided by the average savings volume of $67,974,977, the direct administrative cost is 1.94 percent of average savings volume (1,315,651 / 67,974,977 = .0194).

Table 5.8 summarizes the same information, except that it is separated by asset size for the six large credit unions, four medium credit unions, and five small credit unions.

Table 5.9 summarizes the administrative costs for each group. The consolidated direct and indirect administrative costs for the 15 credit unions were 3.65 percent. The consolidated administrative costs were 3.61 percent for large credit unions, 3.26 percent for medium credit unions, and 8.43 percent for small credit unions. Large credit unions had higher administrative costs than medium credit unions because they had invested more heavily in marketing activities. Direct and indirect administrative costs were significantly higher in the small credit unions mainly because of the lower savings volumes in those institutions.

The data clearly indicate that economies of scale take over once a credit union reaches $1 million in savings volume. While the administrative costs were higher in the small credit unions, they were still competitive with most commercial sources of credit. For the medium and large credit unions, there was a clear economic advantage in

Table 5.7 Summary of Direct and Indirect Administrative Costs in a Sample of 15 Credit Unions

Cost Areas	Administrative Costs of Savings Mobilization	%
Average savings volume	67,974,977	
Direct administrative Costs	1,315,651	1.94
A. Human resources	862,355	1.27
B. Marketing	373,002	0.55
C. Commissions	80,294	0.12
Indirect administrative costs	1,164,989	1.71
A. Human resources	350,782	0.52
B. Administrative services	321,801	0.47
C. Depreciations	415,980	0.61
D. Protection	76,426	0.11
Total administrative costs	6,649,475	
Total administrative costs related to savings mobilization	2,480,640	3.65
% of total administrative costs related to savings mobilization		37.31

All costs are rounded to nearest whole in U.S. dollars.

mobilizing savings over borrowing from external credit sources. Table 5.10 illustrates the advantages of mobilizing savings compared to borrowing external credit.

To answer the second question—Is microsavings mobilization feasible?—we studied four credit unions in Guatemala. The credit unions used a commercial software program to manage their accounting, lending, and teller (deposit-taking) functions. They were all large, experienced, self-sustainable institutions. Three credit unions were located in rural areas; one was located in an urban area. While four credit unions may not provide sufficient evidence to make conclusive statements about savings in d all types of institutions, they did provide a unique snapshot of the deposit-taking function. In these four credit unions we

Table 5.8 Summary of Direct and Indirect Administrative Costs According to Credit Union Size

	Six Large Credit Unions		Four Medium Credit Unions		Five Small Credit Unions	
Cost Areas	Cost	%	Cost	%	Cost	%
Average savings volume	55,255,795		11,373,026		1,346,156	
Direct administrative costs	1,120,665	2.03	138,063	1.21	56,923	4.23
A. Human resources	734,969	1.33	87,922	0.77	39,463	2.93
B. Marketing	305,646	0.55	50,141	0.44	17,215	1.28
C. Commissions	80,049	0.14	0	0.00	245	0.02
Indirect administrative costs	875,844	1.59	232,531	2.04	56,614	4.21
A. Human resources	246,268	0.45	71,800	0.63	32,714	2.43
B. Administrative Services	259,520	0.47	46,977	0.41	15,304	1.14
C. Depreciations	312,263	0.57	96,591	0.85	7,126	0.53
D. Protection	57,793	0.10	17,163	0.15	1,470	0.11
Total administrative costs	**5,150,344**		**1,249,146**		**249,985**	
Total administrative costs related to savings mobilization	**1,996,509**	**3.61**	**370,594**	**3.26**	**113,537**	**8.43**
% of total administrative costs related to savings mobilization		**38.76**		**29.67**		**45.42**

All costs are rounded to nearest whole in U.S. dollars.

Table 5.9 Summary of Administrative Costs by Group

Group	Administrative Costs %
Large Credit Unions	3.61
Medium Credit Unions	3.26
Small Credit Unions	8.43
Consolidated 15 Credit Unions	**3.65**

Table 5.10 The Total Costs of Savings Mobilization Versus Borrowing Costs of the Banking Sector[1]

	Weighted Average in Sample					
Country	Financial Costs %	Direct Administrative Costs %	Indirect Administrative Costs %	Total	Borrowing Costs in Banking Sector	Difference
Bolivia	15.54	0.79	1.31	17.64	19.50	1.86
Ecuador	4.54	1.62	2.16	8.32	17.71	9.39
Guatemala	9.12	2.33	1.64	13.09	18.80	5.71
Nicaragua	17.02	5.12	6.29	28.43	29.65	1.22

[1]*As of December 2001.*

can answer without reservation: Microsavings mobilization is feasible.

The first evidence of the feasibility of microsavings mobilization is found in the structure of the deposit base of the four credit unions, as shown in Table 5.11. The structural analysis reveals important facts:

- Eighty-nine percent of the total savings accounts had balances of less than $300.
- The small accounts (of less than $300) provided only 8 percent of the volume used to fund the loan portfolio.
- Eighty-two percent of the volume of funds came from savings accounts with balances greater than $1,000.

An administrative cost ratio analysis also revealed the feasibility of microsavings mobilization. The analysis is summarized in Table 5.12.

As outlined in Chapter 2, the PEARLS prudential standard calls for an administrative cost ratio of less than 10 percent. All of the credit unions had acceptable levels of administrative costs. If we compare these administrative cost ratios to the non-governmental organizations (NGOs) profiled in the November 2001 issue of the *MicroBanking Bulletin*, the consolidated ratio of 7.96 percent is one-third that of the NGOs, which had a consolidated ratio of 26.8 percent. The administrative cost ratio used in the *MicroBanking Bulletin* includes in-kind donations, which may not be fully expensed by the NGO on the income statement.

Table 5.11 Structure of Deposit Base in Four Guatemalan Credit Unions[1]

Range of Deposit Amount	Number of Accounts	%	Volume	%
< 300	103,112	89.0	2,966,672	8
301 – 1,000	6,285	5.4	3,567,178	10
1,001 – 6,250	5,430	4.7	13,601,235	38
6,251 – 12,500	750	0.6	6,766,009	19
12,501 – 37,500	296	0.3	5,790,712	16
> 37,501+	45	0.0	2,927,819	8
Total	**115,919**	**100.0**	**35,619,675**	**100**

All numbers are rounded to nearest whole, in U.S. dollars.
[1] *As of December 2001.*

Table 5.12 Administrative Cost Ratios in Four Guatemalan Credit Unions[1]

Credit Union	Administrative Cost Ratio[2] %
#1	10.01
#2	8.12
#3	7.79
#4	6.98
Consolidated	**7.96**

[1] *As of December 31, 2001.*
[2] *The Administrative Cost Ratio is defined as the total administrative costs (excluding financial costs and loan loss provisions) divided by the average total assets.*

This ratio is the same as the R9 ratio of PEARLS since the credit unions examined had no in-kind donations.

If we take the analysis a step further and break out the costs of savings as a percentage of average savings on deposit, we see another economic advantage of savings mobilization. When the administrative costs of savings mobilization are separated from total costs, they represent 3.94 percent of the average savings deposit base. When the administrative costs are added to the interest paid on deposits (9.10 percent), the total operating costs for the entire savings program are 13.04 percent of average savings in the four credit unions. At the time of writing, the commercial borrowing rate for MFIs in Guatemala was approximately 19 percent. In other words, the costs of mobilizing savings were about 6 percent less than the commercial borrowing rate. Even for the small credit union with the highest administrative costs, the financial costs of 9.1 percent plus the administrative costs of 8.4 percent (for a total cost of 17.5 percent) are competitive with and marginally lower than the commercial borrowing rate of 19 percent. Whether 5 percent or 0.5 percent, the economic savings goes straight to an institution's bottom line.

The transaction histories of the four Guatemalan credit unions confirm the feasibility of microsavings mobilization. Utilizing the standardized accounting software program used in the four credit unions, we established a relationship between the structure of the deposit base and the volume of transactions by deposit size. Table 5.13 summarizes the savings and withdrawal transactions for these credit unions for 2001.

The data in Table 5.13 show a direct correlation between the structure of the deposits and the size of the transactions. Of the 476,933 deposits and withdrawals that occurred in 2001, 70.1 percent (or 334,369) were for amounts less than $100. The average transaction size of this group was $28. This is consistent with the deposit structure, which shows that 89 percent of the savings accounts had balances of less than $300.

The administrative cost ratios, the structures of the deposit base, and the transaction histories demonstrate three key points about savings mobilization in the credit unions analyzed:

1. Microsavings accounts are an integral part of the savings services offered.
2. Poor and low-income people frequently use the credit unions' savings services to deposit and withdraw money to meet daily liquidity needs.
3. Microsavings mobilization is feasible if balanced with larger savings accounts. The larger accounts provide the volume to fund lending activities and spread the fixed costs of offering savings services to all income groups.

Table 5.13 Consolidated Transaction Histories in Four Guatemalan Credit Unions During Calendar Year 2001

Transaction Amount	Number of Transactions	Volume	Average	%
Deposits				
< 100	191,304	4,581,353	24	71.4
100 – 400	46,315	10,086,534	218	17.3
401 – 800	11,718	7,560,175	645	4.4
> 801	18,596	72,673,943	3,908	6.9
Subtotal	267,933	94,902,004	354	100.0
Withdrawals				
< 100	143,065	4,833,288	34	68.5
100 – 400	48,938	12,212,206	250	23.4
401 – 800	8,829	6,257,594	709	4.2
> 801	8,168	32,182,280	3,940	3.9
Subtotal	209,000	55,485,369	265	100.0
Summary				
< 100	334,369	9,414,641	28	70.1
100 – 400	95,253	22,298,740	234	20.0
401 – 800	20,547	13,817,770	672	4.3
> $801	26,764	104,856,222	3,918	5.6
Total	**476,933**	**150,387,373**	**315**	**100.0**

All numbers are rounded to nearest whole, in U.S. dollars.

Of the 15 credit unions studied, there were no instances where savings mobilization failed or where external credit would have been the preferred alternative. Although the administrative costs varied, all credit union managers indicated that savings mobilization was vital to service the membership and to the self-sustainability of the institution. Furthermore, all the credit unions—large, medium, and small—had successfully engaged in microsavings mobilization. The structure of the deposit base was remarkably similar across all 15 credit unions. They all had many small accounts with balances below $300 and few large accounts with balances above $800 that accounted for most of the savings volume.

These findings should provide encouragement to managers of MFIs who are considering mobilizing savings. Notwithstanding commentaries circulating within the microfinance industry, the 15 credit unions in this study showed that (1) savings mobilization is a viable alternative to borrowing external credit, and (2) microsavings mobilization is feasible.

Ten Tips to Lower the Costs of Savings Mobilization

The following tips for designing and implementing cost-effective savings mobilization programs stem from the study findings as well as from the experience of the authors, who have designed many successful savings mobilization programs in credit unions throughout Latin America.

1. Diversify the Base of Savings Clientele

Mixed outreach is key to successful savings mobilization. A savings institution must diversify its target group beyond just the poor and extreme poor to mobilize the volume of savings needed to fund growing loan portfolios and to spread fixed costs. This study and credit union experience show that the large volume of savings resources used to fund loan portfolios comes from clients who are *net savers*. This group of people is different from the traditional *net borrowers* of most MFIs. Net savers are people who save for the sake of saving.

The success a savings mobilization program achieves will depend on the ability of the institution to reach out to different segments in the marketplace and attract net savers from varying economic strata. This concept may be unattractive to those institutions that target only poor clients; but credit unions with successful programs have found that they can reach more poor and low-income members if they also serve higher-income segments of the marketplace. In other words, a mixed outreach enables an institution to use the larger volumes of resources generated by higher-income clients to offset the higher transaction costs of serving poorer clients. This allows the institution to maintain a competitive administrative cost structure. The same principle holds for lending to the poorer borrowers.

2. Manage Two Critical Economic Variables: Volume and Cost

The entire "business" of savings mobilization hinges on high volume and low costs. As demonstrated in this chapter, once a credit union achieves $1 million in savings volume, costs as a percentage of average savings volume start to drop. Smaller savings accounts and low volumes increase the costs of providing savings services. To achieve the required volume, it is necessary to reach out to clients of varying economic levels. The high volume that higher-income clients provide is integral to sustainability.

The most significant costs associated with savings mobilization are the human resource costs. Table 5.14 shows the average compensation costs of the key credit union staff involved in savings activities. This table can be used to compare the personnel costs of credit unions to other types of MFIs. The main reason why credit unions have achieved high levels of operating efficiency is because they have been successful in controlling human resource costs in accordance with the asset size of their institutions.

Table 5.14 Average Annual Compensation for Key Personnel Grouped by Credit Union Size

Position	Six Large Credit Unions	Four Medium Credit Unions	Five Small Credit Unions
General Manager	26,110	16,459	6,594
Branch Office Manager	8,741	4,776	3,264
Director of Marketing	13,146	--	--
Marketing Technician	4,543	5,263	1,881
Head Cashier	6,827	6,669	5,348
Teller	4,707	3,527	2,754
Chief Accountant	9,724	12,204	3,860
Security Guard	3,989	2,500	1,794

All numbers are rounded to nearest whole in U.S. dollars.

3. Recover the Direct Costs First

During the initial phase of a savings program, the first priority should be to recover the direct costs of establishing the program. The direct costs are critical because they involve real outlays of funds that affect operating efficiency. Indirect costs are also important, but lending services generally cover most of the indirect costs when credit unions start aggressive savings mobilization programs.

When asked about indirect costs, none of the 15 credit unions studied had an effective way to calculate indirect costs and allocate them among savings and credit products. For those managers, their priorities were to quickly recover the direct costs, generate sufficient revenue to cover all the costs, and earn enough profit to build capital reserves. Only one of the 15 credit unions examined was not operationally sustainable (that is, it could not cover all operating costs without a subsidy). This was due to inadequate savings volume.

4. Invest in Security

Security costs are significant in savings mobilization. Creation of a safe place for people to deposit their money must be a priority in a savings-based financial institution. In addition to security guards who protect the physical facility, other important considerations are:

- Purchasing sufficient insurance to cover robbery, assaults, and employee theft;
- Maintaining minimum levels of liquidity in the vault and in cash drawers;
- Establishing alternative sites and transportation to those sites to store excess cash, securities, and legal document; and
- Creating adequate internal controls to prevent fraud or insider theft.

These security components must be included in counting the costs of a savings program.

5. Penetrate the Local Market Before Opening Branch Offices

When launching or expanding a savings mobilization program, it is most important to focus on the existing, untapped markets near the central office before opening new branch offices. The most successful credit unions emphasize marketing in the local market near the central office before expanding to other areas. The central office is best able to support the increases in savings deposits with its existing infrastructure, without incurring the additional costs associated with opening a branch office.

6. Add Value to Savings Products While Minimizing Financial Costs

One of the most cost-effective ways to attract savers is to offer highly demanded benefits; for example, free life insurance coverage on savings account balances. These benefits are less costly to the institution than raising interest rates. Promotions attract depositors without raising financial costs. Providing preauthorized lines of credit based on certain savings levels can also add significant value to savings services.

7. Use the Appropriate Marketing Strategy for Each Target Niche

Two principal marketing strategies are employed by the credit unions: mass marketing (mass media) and personal marketing (individual attention). Mass marketing strategies are most effective for reaching poor and low-income people who will maintain small balances. On the other hand, mass media alone is ineffective for reaching potential clients who have substantial resources to save. Larger savers are not easily convinced of the safety and soundness of a financial institution through mass media advertising. They tend to respond well to personal visits in which their questions can be answered immediately. Although personalized marketing is more costly than mass marketing, the potential to attract substantial volumes of savings is much greater. It is important to properly identify the clients by their potential for saving and implement the appropriate marketing strategy for each target group; for example, it would not be cost-effective to personally call on clients who lack the potential to save larger amounts.

8. Match the Advertising Costs to the Size of the Deposit Base

Once the different market niches have been identified, advertising budgets must be set in relation to the potential deposit base. In this study, the average costs for publicity and promotional activities amounted to 0.5 percent of the deposit volume. Radio, television, and newspaper advertising can be costly. Radio has proven to be the most effective advertising medium for credit unions, particularly in rural areas where people may not have easy access to newspapers or television.

9. Start Without Software if Necessary

Integrated software programs that combine accounting, lending, and teller functions are not necessary to start or expand savings programs.

Of the 15 credit unions studied, eight did not use an integrated software package to manage their savings activities. Those credit unions had not purchased software because of the high technology and maintenance costs associated with it. Of those eight, the largest credit union had more than 6,000 clients with total assets of more than $5 million.

10. Involve Everyone in Savings Mobilization

The most successful credit unions expect all of their employees to participate in savings mobilization programs. Managers recognize that employees are their best resources to publicize the benefits of savings to families, friends, and acquaintances. The study found that most of the credit union employees had some responsibility and involvement in bringing in new deposits. The most common approach is to set savings volume goals for each staff member. In addition to an employee's normal job responsibilities, he or she is also responsible for bringing in new savers to the credit union. This is an inexpensive and effective strategy for mobilizing increased savings.

Conclusion

This chapter provided readers with a practical methodology for determining the costs of savings mobilization and demonstrates its cost effectiveness. Our costing methodology divided savings-related costs into three main areas: financial costs, direct administrative costs, and indirect administrative costs.

The financial costs include the interest and dividends paid to clients on their savings and share accounts and the insurance and taxes paid by the institution on behalf of clients. The direct administrative costs are those directly related to savings mobilization; therefore, they do not need to be allocated. These direct administrative costs include human resources, marketing, and commissions. We developed a methodology for allocating indirect administrative costs. The methodology allocates indirect administrative costs using three criteria: transaction-based, physical space-based, and time-based. Table 5.5 shows how this costing methodology works in a real credit union.

The data in Table 5.8 show that the percentage of direct and indirect administrative costs of savings mobilization dropped significantly when a credit union reached the $1 million threshold of savings volume. The consolidated administrative costs for the 15 credit unions in the study were 3.65 percent of average savings deposits. Finally, Table 5.10 shows the costs of mobilizing savings compared with borrowing from external credit sources. In each country in the study, there were economic advantages that favored savings mobilization, ranging from a low of 1.22 percent to a high of 9.39 percent. Another important advantage of savings mobilization is the freedom of being economically and strategically independent of donors and other third-party financiers. These organizations tend to impose their own reporting requirements, which can interfere with the overall development and strategic direction of a financial institution and, as such, represent higher implicit operating costs.

Lastly, we shared tips for designing cost-effective savings programs that we learned over many years of experience with savings mobilization. Of all the tips presented, the most important one is to diversify the client base of savers. Perhaps the greatest misperception of those who challenge the feasibility of savings mobilization is the assumption that savers and borrowers are the same group of people; they are different groups. By targeting the market niche of net savers, a savings institution will be able to achieve the volume of resources needed to fund its loan portfolio and become self-sustainable.

The model presented in this chapter was validated by empirical data. Credit union movements around the world have consistently shown that savings mobilization is both feasible and cost effective. Highly-demanded savings services can be provided to low-income clients on a sustainable basis if the program is properly designed. The study presented here shows that a well-designed and cost-effective savings mobilization program will bring financial independence to the institutions, as well as highly demanded services to their low-income clients.

CHAPTER 6 Nicaragua: Putting the Framework Into Place

José Benito Miranda Díaz

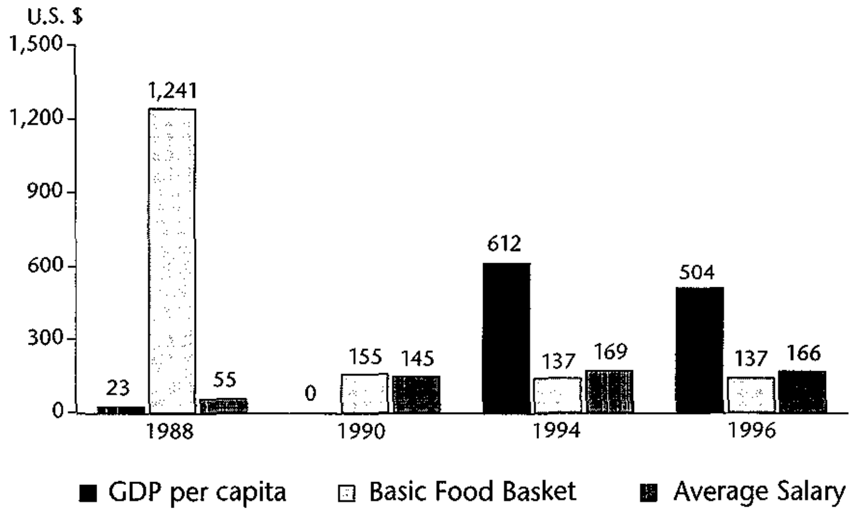
In 1996, WOCCU began a program in Nicaragua called the Rural Credit Union Program (RCUP), financed by the United States Agency for International Development (USAID). The objective of the program was to develop a new financial service option for low-income people, especially the rural poor, by strengthening credit unions so that they would be able to provide safe and effective savings services. Eighteen credit unions were selected to participate in a program of institutional strengthening that would enable them to begin mobilizing savings. This case study presents the experience of three of those institutions.

When RCUP began, Nicaragua was in a post-war period, battling the economic difficulties caused by the armed conflict and by earlier government policies. In 1996, Nicaragua had a population of 4,548,800, with an economically active population of 33 percent. The official unemployment rate among the economically active was 16 percent. Hyperinflation had reached as high as 33,548 percent in 1988, dropped to 13,490 percent in 1990, and had stabilized at about 12 percent by 1996.

Gross domestic product (GDP) per capita was $504; growing at a rate of 2 percent in 1996. An individual with an average annual salary of $166 faced a cost of $137 for the basic food basket (a family's basic food needs for a year). Figure 6.1 shows the relationship between GDP per capita, average salaries, and the basic food basket. The graph in Figure 6.1 illustrates the improvement in the Nicaraguan standard of living from 1988 to 1996. Despite the improvement, the economic situation was still difficult for most Nicaraguans in 1996.

Savings capacity was very low in 1996. In previous years, the repeated pattern of major devaluations and the hyperinflation resulted

Figure 6.1 Variations in the Standard of Living in Nicaragua



in real losses for those who held savings accounts in the country. Consequently, many people had developed a serious mistrust of savings institutions.

Most people lacked access to financial services. The formal financial system in 1996 was composed of 14 banks and two finance companies, all regulated by the Superintendent of Banks. The credit union sector comprised 108 credit unions that offered credit, limited savings, and other financial and non-financial services. Of the 108, 18 were closed membership and 90 were open membership. Thirty-four credit unions were based in the capital city of Managua and 74 were located in small cities and rural areas. With few exceptions, the credit unions were small, with an average membership of less than 100.

Forty-one of the 108 credit unions participated in a diagnostic analysis conducted by WOCCU. The results of the analysis indicated that the entities:

- Focused more on lending than on savings mobilization.
- Were managed by people with little financial knowledge.
- Depended on external funds—mainly from non-governmental organizations (NGOs), international development banks, or foreign governments—to finance their loan portfolios.

- Had few resources. The resources they did have were obtained through member share contributions, which in most cases were obligatory and periodic.
- Held loan portfolios with high levels of delinquency.
- Lacked the necessary expertise and tools to manage their portfolios.
- Were short of liquidity.
- Performed few or no marketing activities.

Few of the 41 credit unions offered voluntary savings services. The few that did provide such services had only one product: passbook savings. The passbook account usually paid a market-based interest rate, but since it did not keep up with inflation, the deposits did not maintain their value. Share contributions were really the sole source of internal financing for the credit unions, but few paid interest on the shares.

Credit unions operated under the 1971 General Law of Cooperatives, with regulations established in 1974. The General Law established cooperatives as legal entities with private rights. The regulations gave cooperatives the legal authority to engage in financial activities with their members: to receive savings deposits, to make loans, and to offer discounts. There were no specific regulations that set prudential standards that credit unions would be required to meet as financial institutions intermediating savings and loans.

Credit union bylaws hindered progress, since they had been written for inward-looking social organizations. The bylaws did not contain the necessary standards, controls, and policies for governing sound financial intermediaries. The accounting systems in the credit unions were outdated and difficult to use. The institutions lacked formalized policies for credit, collections, or savings. They also lacked internal controls. Before mobilizing savings, the credit unions would all have to address these weaknesses.

This chapter describes the process undertaken by RCUP and three of the credit unions to develop the framework for savings mobilization. Today, these credit unions belong to the new *Sistema de Cooperativas de Ahorro y Crédito Financieras* (Financial Credit Union System) in Nicaragua. The three credit unions are Avances Credit Union, Iaguei Credit Union, and Moderna Credit Union.

Avances Credit Union (Cooperativa de Ahorro y Crédito Financiera Avances, R.L.)

Avances Credit Union was established in 1969. It is located in Santo Tomás, provincial capital of the department of Chontales, 180 km. east of Managua. The population of Chontales in 1996 was 144,635, of which 15,997 resided in Santo Tomás. Santo Tomás was the target market of Avances. Avances had only 195 members, for a market penetration rate of 1.2 percent. One bank provided the only competition in the area. The primary economic activities in the region are beef, dairy, and leather production.

By 1997, Avances had grown to 358 members, with assets of $284,440. Almost 59 percent of assets were financed by external credit, while savings financed only 11 percent. Fifty-nine percent of Avances' assets were placed in loans, 5 percent were invested in bank deposits, 2 percent were in cash, and 34 percent were in non-earning assets. Loans produced a return of 54 percent, but the credit union generated a net surplus of only 0.55 percent.

Avances did not have a chart of accounts, and the existing accounts were not detailed, which made an analysis of financial management difficult. The credit union did not have provisions for delinquent loans. Instead, it purged all uncollectible loans from the books. Avances had credit guidelines, but no one to administer the portfolio. The institution did not analyze delinquency, nor did it have a collections policy. Interest rates on loans were very high. Avances did not have a business plan to guide operations, and no marketing activities were carried out.

Iaguei Credit Union (Cooperativa de Ahorro y Crédito Financiera Iaguei, R.L.)

Iaguei Credit Union was established in 1976. It is located in Corinto, in the department of Chinandega, 180 km. east of Managua. The population of Chinandedga in 1996 was 350,212, of which 17,177 lived in Corinto, the target market of Iaguei. The credit union had only 95 members, for a market penetration of 0.55 percent. Iaguei's local competition included one other credit union and a bank. The economy of this region is based largely on fishing.

When Iaguei joined the RCUP project in 1997, it had assets of

$22,165. One percent of assets were financed by member savings and 55 percent were financed with share contributions; the rest were financed by institutional capital contributed by donations. The credit union managed only 12 passbook savings accounts, with an average of $21 per account. Seventy-one percent of assets were placed in loans, 5 percent were invested in banks, 3 percent were in cash, and 20 percent were non-earning assets. Loans produced a return of 61 percent, yet the credit union generated a net surplus of only 7.8 percent.

The accounting manual was out of date and the accounts were not detailed. Iaguei had a delinquency rate of 13 percent. It had no policies for credit or collections and there were no loan loss reserves. Iaguei did not perform delinquency analyses, nor did it have personnel to administer credit. Iaguei performed no marketing activities.

Moderna Credit Union (Cooperativa de Ahorro y Crédito Financiera Moderna, R.L.)

Moderna Credit Union was established in 1972. It is located in Estelí, provincial capital of the department of Estelí, 145 km. north of Managua. The population of Estelí in 1996 was 174,894, of which 93,441 lived in the city of Estelí, the target market of Moderna. Moderna had 437 members, for a market penetration of only 0.47 percent. Its local competition included three credit unions, three NGOs, and five banks. The economy of the Estelí region is based on cattle raising and coffee cultivation.

When Moderna joined the RCUP project in 1997, it had assets of $142,846. Sixty-nine percent of assets were financed with share contributions from members, while savings financed only 4 percent. The credit union managed 44 passbook savings accounts, with an average of $144 per account. Seventy-eight percent of assets were placed in loans, 3 percent were invested in banks, 1 percent in cash, and 19 percent in non-earning assets. Loans produced a return of 49 percent, but Moderna operated at a loss of 3.2 percent.

Moderna had numerous delinquent loans, many of which were owed by directors and employees. It had no provisions for delinquent loans. Moderna had no credit or collections policies and did not perform any delinquency analyses. It did not have a business plan and it performed no marketing activities.

Strengthening the Institutions

To initiate savings mobilization in these three credit unions, the institutional strengthening program was implemented in three phases.

Phase I: Selecting the Pilot Group

The first phase involved the selection of the pilot group of credit unions. The prerequisites for credit unions interested in participating in the program were: market viability, open membership, and willingness to commit to new disciplines and work systems. Credit unions were selected based on a thorough diagnostic analysis. The 41 credit unions registered at the start of the study were evaluated for more than six months. These 41 credit unions were selected because they were open bond and because they operated with the most consistency and continuity. The analysis of these credit unions covered their strategic planning, organizational structure, human resources, standardization and systematization of operations, financial administration, credit operations, marketing operations, deposit services, membership process, and internal controls.

The initial diagnostic analysis indicated that the credit unions had to undertake a number of institutional reforms before they could begin to aggressively mobilize savings. The reforms included:

- Instituting or improving existing savings policies;
- Ending dependence on external credit;
- Modernizing their statutes and bylaws;
- Updating and adding detail to their accounting manuals;
- Implementing new financial disciplines;
- Creating business plans;
- Developing marketing plans;
- Lowering delinquency;
- Training employees; and
- Applying PEARLS to monitor financial management.

After the analysis, and after serious discussions among managers and directors, 18 of the 41 credit unions committed to the strengthening program. They agreed to put in place the financial management disciplines and policy reforms required to be able to receive technical assistance in savings mobilization from RCUP.

Phase II: Establishing Financial Discipline

In the second phase of the program, the 18 credit unions learned financial management disciplines. They began to use PEARLS to evaluate their progress. The amount of time this process required depended on the willingness of the managers and boards of directors to accept the challenges of reform, and on the speed with which each accomplished the necessary policy changes.

Before progressing to Phase III, the credit unions had to achieve the following:

- Their accounting systems had to be brought up to date,
- They had to send financial reports and delinquency reports during the first 15 days of the month to the RCUP office;
- The managers, staff, and members had to participate in all RCUP training sessions and meetings;
- They had to demonstrate a business-oriented philosophy by adjusting their existing bylaws; adopting new policies for credit, collections, and internal control; establishing provisions for delinquent loans in accordance with WOCCU standards; and instituting a business plan.

Phase III: Savings Mobilization

The third phase of the program focused on image improvement, marketing, and savings mobilization. RCUP provided training and technical assistance in savings product development, marketing, and savings management. The credit unions had to first demonstrate:

- Delinquency of less than 15 percent;
- No new external credit since joining the project;
- Accounting reconciled and up to date;
- Financial reports (accounting, delinquency, marketing) updated and sent to RCUP during the first 15 days of each month, for at least five months in a row;
- Active participation in all training events;
- Gross financial margin which allowed compliance with coverage for operating expenses, provisions for risk assets, and contributions to capital reserves;

- Liquidity equal to 25 percent of total deposits;
- Growth in institutional capital;
- Use of PEARLS to monitor financial management; and
- Creation and implementation of business and marketing plans.

Those credit unions that met the qualifications received financial assistance to improve the images of their institutions: to create professional, well-kept structures, to improve convenience for members, and to support marketing programs. They also received technical assistance to develop, manage, and market savings products. The Phase III credit unions became part of the branded national network of the *Sistema de Cooperativas de Ahorro y Crédito Financieras*. The three credit unions presented here—Avances, Iaguei, and Moderna—all met the requirements in 1998, and began the third phase of image improvement, marketing, and savings mobilization during that year.

Policies and Procedures

In building their savings programs, the credit unions had to ensure that they would be able to protect the deposits they mobilized. Many of the discipline and policy changes the three credit unions had to undertake contradicted entrenched practices and customs.

Policy Changes

None of the 18 credit unions selected at the beginning of the project had a clear strategy for savings mobilization and none had formalized savings policies and procedures. The three credit unions presented in this case study offered two savings products: passbook accounts (demand savings) and fixed-term deposits. There were no manuals for administering the products and no marketing program to promote them.

For the most part, the three credit unions had been raising money from members via traditional means, through periodic member share contributions that did not often earn interest. When shares did earn interest, the return was usually below the rate of inflation. The credit unions, under the cooperative law, were required to divide any surplus among members. Some paid dividends to members in proportion to shares held, but since net surpluses were so low, the dividends were minimal. The incentive for making share contributions was that those members would then be eligible for a loan. The maximum amount of credit would be determined by a member's total share contributions; the loan size would be a multiple of the shares invested. In other words, members had to invest in shares in order to gain access to credit.

Avances had two fixed-term deposit products of six and 12 months that paid annual rates of 11 and 12 percent, respectively. Avances offered a passbook savings account as well, paying 10 percent annually. The credit union pegged the value of the account to the dollar to maintain real value. The minimum required opening balance was $0.53 (C$5). Few voluntary savings had been deposited with Avances—$5,603 in total.

Iaguei raised mainly share contributions, for which it paid dividends at the end of the year, based on the annual income of the credit union. It did not offer fixed-term deposit accounts. Iaguei offered a withdrawal savings product, for which it did not pay interest. It had mobilized a total of $256 in voluntary savings.

Moderna did not have established savings policies, and did not encourage savings among members. Moderna focused on obtaining share contributions. It did offer a passbook savings account, for which it paid an interest rate of 10 percent, compounded every six months. Moderna had raised a total of $6,331 in voluntary savings by 1997.

Obligatory share contributions, not voluntary savings, were the main source of financing in the three credit unions. Before starting programs to mobilize voluntary savings, the three credit unions needed to learn about the demographics of their target markets. They also needed to create physical images and structures that would be attractive to the public and offer both convenience of service and security. The credit unions would have to present employees who were friendly and professional. They would also have to establish operating hours that were competitive and compatible with the needs of the members, and acquire adequate levels of technology to increase efficiency.

Avances, Iaguei, and Moderna needed to offer competitive services in their local markets if they wanted to mobilize savings. This required active management of the interest rates offered on savings, establishment of modern and flexible policies, and institution of financial disciplines to protect the savings. The credit unions had to create marketing programs that would generate adequate liquidity flows to meet the goals set out in their business plans.

Steps to Protect Savings

The credit unions needed to be able to protect the savings before they could mobilize them. They had to implement transparent accounting systems designed for credit unions. Once the accounting systems were in place at each institution, the credit unions could analyze their financial performance as well as their strengths and weaknesses. Each credit union also had to implement a system to analyze and monitor delinquent loans. They all had to institute risk-based credit screening policies and strict collections programs, so that the loans financed by savings would be based upon sound lending decisions and good repayment cultures. The credit unions had to establish and implement savings policies and procedures so that the deposits mobilized would be soundly managed.

Before offering and promoting new savings products, the credit unions had to comply with the financial disciplines established in PEARLS. These included:

- Liquid assets of 25 percent of withdrawable deposits;
- Liquidity reserves of 15 percent of withdrawable deposits;
- Cash of no more than 1 percent of total deposits;
- Delinquency rate of less than 5 percent of the total outstanding loan portfolio;
- Provisions for 100 percent of loans delinquent 12 or more months;
- Provisions for 35 percent of loans delinquent less than 12 months; and
- Non-earning assets of no more than 5 percent of total outstanding loans.

The board of directors in each institution had to approve the new policies that would protect savings and the managers had to put the new procedures into practice. At that point, the credit unions began to develop and promote savings products.

Product Development

The credit unions conducted market research, mainly through surveys, to identify the characteristics and particular demands of their local markets. With assistance from RCUP, which had developed a basic line of savings products, the credit unions used this information to launch new savings products.

Initial Product Development

Seven savings products were offered by the credit unions at the time of writing: five demand (passbook) accounts and two fixed-term accounts. The products were standardized across institutions. The demand products are described below.

Maximum Account in Cordobas. This is a passbook account in cordobas, which can be opened with C$100 (U.S. $7). Interest is compounded monthly at two points above the market interest rate. The account holder can make unlimited withdrawals during the month.

Maximum Account in U.S. Dollars. This is a passbook account in U.S. dollars, which can be opened with U.S. $10 (C$143). It is similar to the Maximum Account in cordobas. The interest earned on the dollar accounts is greater than the interest earned on the accounts in cordobas, based on market rates.

Maximum Account for Organizations. This account is opened with C$1,000 (U.S. $70). Rules restrict withdrawals from the account and establish the minimum balance.

Youth Savings Account. This is a passbook savings account for the teenage children of members, 12 to 17 years old. The account is in cordobas, with an opening balance of C$5 (U.S. $0.35). The account holder may deposit any amount to earn an interest rate one point above the market rate.

Children's Savings Account. This is a demand savings account for the children of members younger than 12 years old. It resembles the youth account. It offers additional features, including a Children's Club, which allows young savers to become part of a group and learn about cooperative principles.

These products were packaged and launched onto the market in 2001. The credit unions created a brochure describing the products, which was distributed to each member and made available to all prospective members in the local market.

To provide added value on the two individual Maximum accounts, the credit unions offer a protection plan that pays three times the amount saved upon the death of the account holder. In addition, some credit unions offer to collect savings at home or at work.

The *Sistema de Cooperativas de Ahorro y Crédito Financieras* is still small in Nicaragua. Credit unions in the system seek to gain a competitive advantage based on the quality of their services. Efforts are directed to ensure that new products and services are designed to meet the real needs of members and prospective members. All new products are researched and pilot-tested before being launched.

New Products Developed to Meet Market Demand

There were four products in development as of writing. Two were in the pilot phase in test markets and two were in the design stage. All four were to be launched in 2002. These products were designed specifically to diversify sources of funding and to meet the specific demands of different types of savers.

The new products coming on the market are: the Christmas Account, the Progressive Account, and the Salary Account.

Christmas Account. The member saves a fixed amount every month for 11 months, starting in January. The total amount saved plus a "free" 12th installment is returned to the member in December. The 12th installment is paid by the credit union, provided the member makes the 11 monthly deposits on time. This product seeks to promote systematic savings with a specific purpose—having extra money at Christmas. An innovative aspect of this account is that it is pegged to the dollar so that value of deposits is maintained relative to the dollar.

Progressive Account. The member saves fixed or variable amounts periodically, all within a limited time frame for a planned total. Once 70 percent of the planned amount has been accumulated in the savings account, including the interest earned, the member can take out a personal loan for the remaining 30 percent needed to reach the amount required to finance the planned expense (or the goal). This account has five models.

Household Appliance and Electronics Account. The member periodically saves a variable amount of money for an established period of time, to accumulate funds for the purchase of an appliance. The member can obtain a loan when he or she has accumulated 70 percent of the value of the item to be purchased. This product promotes systematic savings with the specific purpose of purchasing an appliance. As an added value, the credit union establishes contacts with the main appliance stores in the local market to obtain discounts for users of this program.

University Account. The member periodically saves a variable amount of money for an established period of time for the purpose of paying monthly fees to the university for his or her children. Again, the member can obtain a loan when he or she has accumulated at least 70 percent of the total planned amount. This product seeks to promote systematic savings with the specific purpose of paying for a child's university expenses.

As an added value, the accumulated amount (including interest) plus the loan amount (where applicable) will be returned in monthly payments to the member or paid directly to the selected university. If the university is within the locality, the member will not be charged a fee for this payment service. A small fee is charged for direct payment to a distant university. The balance in the account after each withdrawal continues to earn interest.

Graduation, vacation, and car accounts function in a similar manner, only with different goals.

Salary Account. Designed for members who are small-scale farmers (or even medium-scale or large-scale farmers) who find it difficult to save regular amounts throughout the year and who do not have fixed monthly incomes. Members who want this product must first meet with the savings officer to plan their monthly draw on savings. Next, they deposit an amount from their harvest proceeds that together with the above-market interest rates paid will reach a predetermined total that will provide for the monthly draws. Members are then able to draw on the accumulated savings monthly, on a specific day of the month, an amount that becomes their monthly "salary."

The amount deposited will earn the interest rate that the business plan of the credit union allows at any given time. This amount is calculated in accordance with the monthly amount to be withdrawn to ensure that members have consistent monthly salaries throughout the year.

Eventually, there will be five salary options available, all based on this product model, targeting different groups of income earners.

Market Penetration

In order to mobilize savings, the credit unions had to devise strategies to publicize their presence in the markets and then convince people to deposit their savings in the credit unions. Their new strategies included image improvements, branding, and marketing campaigns.

Image Improvements

The first step in penetrating the market was to change the public perception of the credit unions. These efforts were undertaken with financial support from RCUP. Each credit union that was able to achieve compliance with the standards set out in Phase II entered into the Phase III marketing program. With the financial assistance for image improvement, the credit unions set out to remodel their buildings, upgrade equipment, and print new forms and stationery. The condition of all three credit union buildings was poor. The buildings where the offices were located were often dark, run down, and full of dust mites. They needed to be completely remodeled to create attractive exteriors and welcoming and efficient interiors. The physical improvements were indispensable in improving the professional images and gaining the trust of members.

The RCUP marketing program involved creating the common group image with standard colors, building maintenance standards, signs, and logos. With wide community and media participation, each credit union inaugurated its new building and presented its new image. The idea was to create a new national brand shared by individual credit unions. The photographs that follow show the magnitude of the improvements made at the three credit unions.

The old Avances building, shown in Figure 6.2, was renovated to present a new professional image that incorporated the standardized colors and signs, shown in Figure 6.3.

As Figures 6.4 and 6.5 illustrate, Iaguei made dramatic improvements in its appearance. It had an excellent location near the commercial center of the area.

Figure 6.2 The Old Avances Building in 1996

Figure 6.3 The New Avances Credit Union in 1998

In 1996, the Moderna Credit Union was located in an outlying neighborhood. As shown in Figure 6.6, although it was spacious, the building was badly deteriorated. It did not convey a positive image to the public. Pictured in Figure 6.7, a new building was inaugurated in October 1998. The new office was built in a much better location that was close to the commercial center of the city.

The improvement in public image also involved the offer of new savings products, with standardized, professional-quality forms, and standard procedures. The credit unions also updated their bylaws and statutes so that they would be able to work as a system.

Branding

The new image and changes in the statutes allowed for the creation of a national brand for the new credit union network, the *Sistema de Cooperativas de Ahorro y Crédito Financieras,* in Nicaragua. The 14 credit unions that advanced to Phase III began to use a common logo. The

Figure 6.4 The Old Iaguei Building in 1996

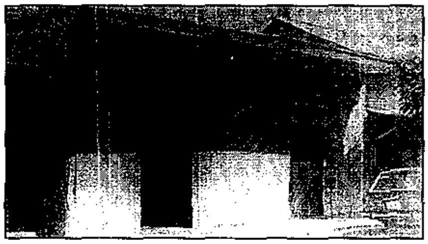
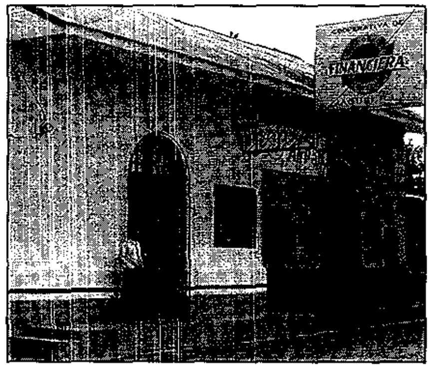


Figure 6.5 The New Iaguei Credit Union in 1998



identifying logo, registered as a trademark, is shown in Figure 6.8. The logo replaced the individual symbols that had identified the credit unions in the past. The new logo represented the standards, disciplines, and quality of the credit unions in the new system. The logo was used on all printed materials.

As illustrated in the photos of the remodeled credit unions, the buildings today are similar in structure and in arrangements of public spaces and work areas. The colors and signs that identify the buildings are also consistent.

Of the 18 credit unions that joined RCUP in 1996, 14 remain as of writing. These 14 credit unions work with standardized policies, procedures, marketing promotions, and products. The branded image demonstrates to the public that the individual community credit unions are part of a larger national financial system characterized by safety, quality, and outreach. The brand communicates that the credit unions in the system are trustworthy institutions, capable of mobilizing and protecting member savings.

Marketing Campaigns: Local and National

After launching the new image, the credit unions initiated marketing campaigns that sought to establish the public image of each credit union as (1) a safe place to save, and (2) an institution that offered

Figure 6.6 The Old Moderna Building in 1996

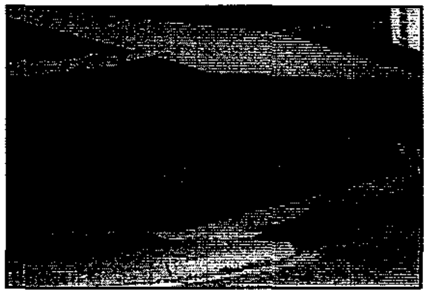
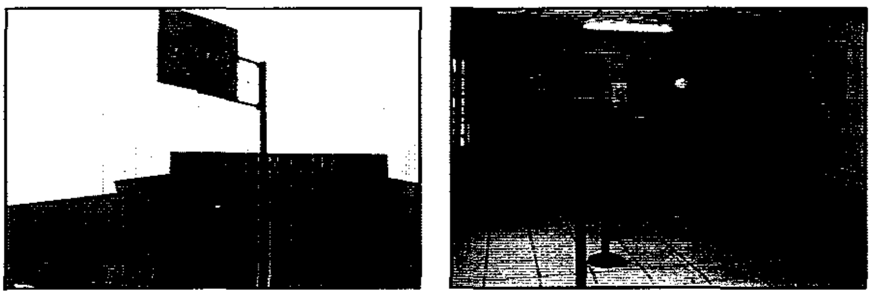


Figure 6.7 The New Moderna Credit Union in 1998

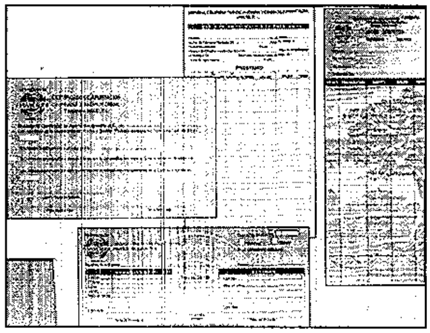


valuable services to its members. After launching their new images, the credit unions used local strategies for marketing during the first two years. During the third year, they began a national marketing campaign.

Promotions. The promotions offered incentives for joining the credit union, opening passbook savings accounts, and establishing savings accounts for children. For saving small amounts of money or for joining the credit union, campaigns offered raffles of commonly used appliances, such as motorcycles, televisions, refrigerators, or electric ranges. The long-term strategy of the credit unions is based on these types of promotions; for example, the raffling of a prize among new members and of another for those who save with fixed-term deposits of six months to one year.

Figure 6.8 The New Logo and Standardized Forms of the Credit Unions

CENTRAL DE COOPERATIVAS
AHORRO
FINANCIERA
Y CREDITO
DE NICARAGUA, R.L.



Publicity. The promotional campaigns included using items such as fliers, brochures, signs, banners, and posters that were strategically placed and distributed in local markets. In addition, the credit unions created a radio spot that talked about the individual credit unions and about the new credit union network. Credit unions encouraged radio talk show hosts to do interviews with managers. This publicity strategy was supported with interviews in local newspapers that had national circulation, and with announcements via traveling car-mounted megaphones.

Sales. Together with the promotional campaigns, credit unions began to organize a sales force. Each credit union that participated in the marketing program was required to contract the services of a marketing officer who would also be responsible for sales. The credit unions then contracted the services of artists (an animator and a magician). Together with the local salesperson and the marketing officer from RCUP, the artists visited marketplaces, businesses, and organizations to recruit new members.

Existing members were encouraged to recruit new members. Members who recruited other members could participate in contests. At the end of a recruiting period, the member with the most recruits won a prize.

Message. The messages used both in local and national campaigns sought to establish a feeling of trust: that the credit unions were safe places to save. This was a difficult message to communicate.

Nicaraguans had become increasingly mistrusting because of fraudulent schemes that had caused the closing of some banks and credit unions. This was a difficult period; eight of 14 banks in operation closed. There were three scandals in credit unions, where the directors had committed fraud against the members. Although the problem credit unions were not part of the new system, their scandals affected the public's perception of all credit unions.

The marketing teams decided to emphasize two messages in this difficult environment. One was to sell the presence of a different kind of credit union: one that operated honestly and in an efficient and professional manner. The other message was that the branded credit unions had a national presence, providing a new level of stability.

Results

By implementing the financial and policy reforms, offering the new savings products, and launching marketing programs, Avances, Iaguei, and Moderna achieved dramatic growth.

Changes in the Credit Unions

The three credit unions commercialized their operations, this was the most notable and important change. The credit unions progressed from running small-scale, disorderly operations to running operations governed by sound policies and effective procedures, with adequate technology and documentation. Information is now properly filed and archived. The employees work with a single chart of accounts, accounting registers, and internationally standardized accounting procedures. Managers monitor the credit unions' financial condition monthly using the PEARLS monitoring system. The managers conduct regular analyses of their portfolios and their delinquent loans to make sure that they are not putting savings at risk.

The credit unions manage their liquidity by monitoring cash flows, maintaining liquidity reserves, and using backup support from the newly created Central Finance Facility (CFF). The CFF monitors and supports the liquidity levels of the credit unions in the network. Each institution must adhere to set standards to be able to store excess liquidity in the CFF and access it as needed.

The credit unions receive and protect member savings according to well-defined procedures. For all the savings products, the credit unions use professional documents, such as printed passbooks, deposit slips, and withdrawal slips. Savings policies and procedures are formalized to guide employees in the administration of savings services. Internal controls have been implemented across the institutions.

Personnel are trained to provide high-quality service and maintain pleasant attitudes. Client service wait-times have been reduced to a minimum, as have registry errors. Providing convenient and quality services to members is now a high priority in all three credit unions.

Growth in the Credit Unions

As the institutions became stronger, presented positive images, and offered increased financial services, they attracted new members. As Figure 6.9 demonstrates, all three credit unions achieved impressive growth in membership from 1997 to 2001. Savings in the three institutions increased dramatically from 1997 to 2001, as shown in Figure 6.10.

As shown in Table 6.1, after four years, **Avances** has grown from 358 members to 2,963 members, from $284,440 in assets to $1,174,509 in assets, from $5,603 in savings to $592,003, and from an average savings account size of $67 to $190. The increase in average account size reflects how Avances is now reaching a larger market with its savings services, as well as offering products that provide better incentives to more savers. The number of employees increased from six to 20. The credit union now operates its central office and one branch.

Table 6.2 shows how Iaguei has grown during the strengthening process. **Iaguei** has grown from 108 members to 2,465, from $22,165 in assets to $393,840, from a total savings of $256 to $359,718, and from an average savings account size of $21 to $144.

The number of credit union employees increased from two to 15. The credit union now operates one central office and one branch.

As shown in Table 6.3, **Moderna** has grown from 504 members to 2,401, from assets of $142,846 to $340,018, from a total savings of $6,331 to $223,401, and from an average savings account size of $144 to $163.

The number of credit union employees increased from five to ten. Moderna now operates both a central office and one branch.

Figure 6.9 Growth in Members

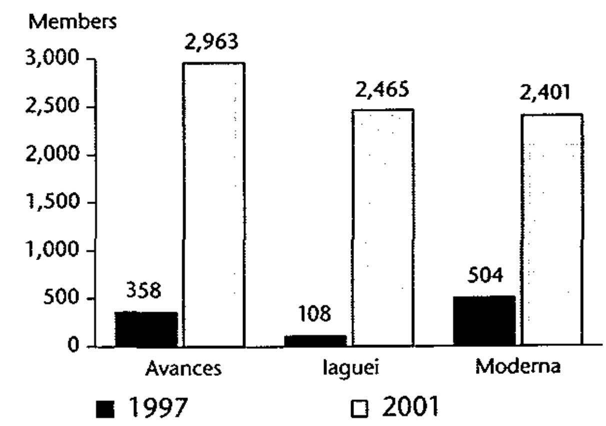


Figure 6.10 Growth in Savings

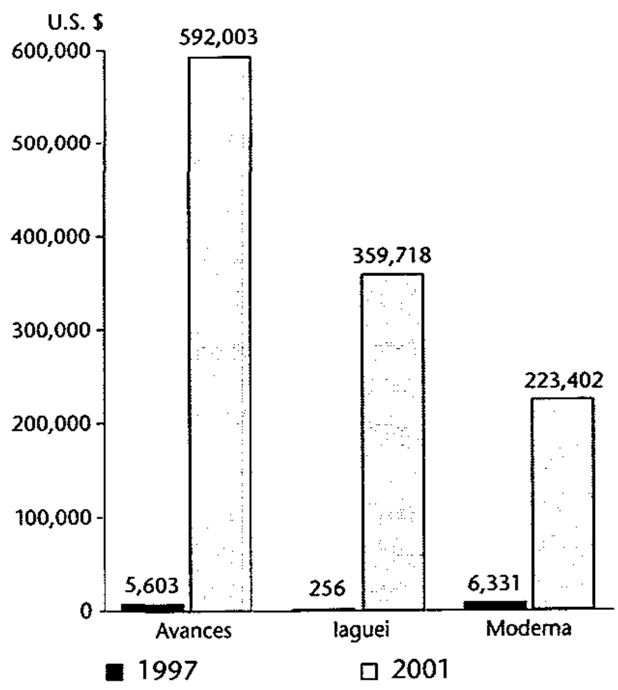


Table 6.1 Growth in the Avances Credit Union

	1997	2001	Difference
Members	358	2,963	2,605
Children of Members		479	479
Assets	$284,440	$1,174,510	$890,070
Savings	$5,603	$592,003	$586,400
Average Savings Account	$67	$190	$123
Net Income/Average Assets	0.55%	1.89%	1.34%
Number of Employees	2	15	13

In U.S. dollars.

Table 6.2 Growth in the Iaguei Credit Union

	1997	2001	Difference
Members	108	2,465	2,357
Children of Members	–	895	895
Assets	$22,165	$393,840	$371,675
Savings	$256	$359,718	$359,462
Average Savings Account	$21	$144	$123
Net Income/Average Assets	7.82%	– 3.18%	– 11.00%
Number of Employees	2	15	13

In U.S. dollars.

Table 6.3 Growth in the Moderna Credit Union

	1997	2001	Difference
Members	504	2,401	1,897
Children of Members	–	895	895
Assets	$142,846	$340,018	$197,172
Savings	$6,331	$223,402	$217,071
Average Savings Account	$144	$163	$19
Net Income/Average Assets	– 3.23%	– 0.07%	3.16%
Number of Employees	5	10	5

In U.S. dollars.

Market Analysis

Avances, as of December 2001, has 3,442 financial service clients; that is, clients using credit and savings services. Of these clients, 2,963 are members and the remaining 479 are the children of members. Fifty-eight percent of the members are women. Thirty percent of the members are microentrepreneurs, 28 percent are service employees, 16 percent are homemakers, 11 percent are farmers, 5 percent are industrial workers, 5 percent are professionals, 2 percent are students, and 2 percent are laborers.

With regard to savings services, Avances has 3,001 demand accounts; 58 percent of the accounts are owned by women. Thirty-one percent of savers are merchants, 25 percent are employees in services businesses, 13 percent are homemakers, 9 percent are professionals, 8 percent are farmers, 6 percent are employees from various businesses, 4 percent are craftsmen or industrial workers, and 2 percent are laborers. The average savings balance is $187. The average age of savers is 38 years old.

Iaguei has 3,360 financial service clients; of these, 2,465 are members and the remaining 895 are children of members. Sixty-two percent are women. Thirty-eight percent of the members are microentrepreneurs, 19 percent are homemakers, 18 percent are employees of various businesses, 8 percent are professionals, 8 percent are students, and 6 percent are employees of service businesses.

For savings services, Iaguei has 2,469 demand savings accounts, of which 62 percent are owned by women. Thirty-nine percent of account holders are microentrepreneurs, 23 percent are employees, 17 percent are homemakers, 6 percent are students, 5 percent are professionals, 5 percent are workers in the service industry, and 2 percent are retired. The average amount of savings is $142. The average age of savers is 38 years old.

Moderna has 2,401 financial service clients; of these, 1,490 are members and the remaining 461 are children of members. Forty-four percent of members are women. Moderna has a savings structure similar to Avances and Iaguei, but was not able to provide the breakdown of members and savings account holders by income-generating activity.

Even though the majority of members today continue to be low-income, the credit unions have been able to attract higher levels of fixed-term deposits and local demand savings from other socioeconomic groups. At the beginning of the program, almost none of the credit unions offered fixed-term deposits. Now, approximately 19 percent of total savings in the three institutions are in certificates of deposit, with amounts ranging from $714 to $14,286 for terms of six months to two years. This diversification enables the credit unions to offer microsavings to large numbers of poor members, while also serving larger-deposit savers, which mitigates the fixed costs of providing savings services and funding the loan portfolios for low- and middle-income borrowers.

Conclusion

In 1996, Nicaragua was a country in a post-war period, with a recovering economy, trying to overcome serious problems in its economic structure and serious distortions caused by the government of the 1980s. Few people believed that Nicaraguan credit unions could improve services and become stronger through savings mobilization. Only 18 of the 41 credit unions analyzed chose to take up the challenge, and four of them dropped out of the program. The managers of the 14 remaining credit unions did believe in savings mobilization. As a result, they lead their institutions to achieve a level of growth that would make them significant financial intermediaries in the Nicaraguan market. Avances, Iaguei, and Moderna were three credit unions that did it.

The institutions had to undertake serious reforms before they could mobilize savings responsibly. None of the 18 credit unions at the beginning of the project had a clear strategy for savings mobilization. The credit unions lacked formalized policies and procedures for savings, or even a savings program at all. Some did not offer voluntary savings products. In preparation for mobilizing savings, RCUP worked with the 18 credit unions to develop: accounting systems, financial management through the PEARLS method, financial disciplines, sound portfolio administration, delinquency analysis, liquidity management, and internal controls.

In order to progress to the savings mobilization phase of the project, the credit unions first had to comply with financial disciplines that would protect the value of the savings, including: liquidity management, liquidity reserves, limits on idle liquidity, delinquency control, provisions for loan losses, limits on non-earning assets, and effective administration of financial and operating costs and returns in accordance with the business plan. All of this was monitored through PEARLS.

Once the credit unions had reliable systems in place, they expanded their activities to create images of quality service. They built physical structures that were attractive to the public and offered tangible security. They trained employees to be friendly and professional. They improved convenience by instituting new operating hours that were compatible with the needs of the members, employing improved technology, and installing communications technology that increased efficiency.

The change in public image involved remodeling of their buildings. There was also a change in the bylaws of each institution that enabled the credit unions to create a nationwide brand. This image standardization allowed the credit unions to demonstrate to the public that they were part of a larger national network grounded in high-quality service and safety standards. The new brand facilitated the marketing of the revitalized institutions, especially in the area of publicity. The credit unions organized local and national campaigns supported by inexpensive and efficient publicity, such as radio advertisements. They also developed a sales force and special promotions to grow the membership.

Product development has been key to the success of the savings programs. Currently, the credit unions offer seven savings products: five demand (passbook) accounts and two fixed-term accounts. The products were all designed according to the unique characteristics of the Nicaraguan market and the particular demands of the members. There are four new products in development; two are in the pilot phase and two are in the prototype design stage as of writing. These products have an advantage over the competition because they have been designed according to the researched needs of particular niches of members, and are based on quality of service.

All three credit unions achieved dramatic growth in both membership and savings by offering targeted savings products and presenting themselves as efficient financial intermediaries capable of protecting those savings. They were also able to diversify their membership bases.

Many lessons can be taken from the experiences of the Avances, Iaguei, and Moderna credit unions in strengthening their institutions through savings mobilization. Perhaps the greatest lesson is that savings mobilization does not only mean adding a few new products to the existing loan product portfolio; rather, it requires a complete reorientation of a credit-focused institution into a full financial intermediary. This process includes evaluation of existing financial management, implementation of new policies and procedures to protect and manage savings, and creation of institutional images and marketing that will convince savers in the local market that they will benefit from depositing their savings in the institution.

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CHAPTER 7 Ecuador: Stability in a Time of Crisis

César Izurieta Moreno

This case study examines two credit unions in Ecuador to evaluate the key elements of their success in mobilizing savings during economic and political crises. **San Francisco, Ltd.** is located in the city of Ambato, northeast of the capital city of Quito. **23 de Julio, Ltd.** is located in the city of Cayambe, south of Quito. The two credit unions have several similar characteristics, while operating in different markets. Both credit unions took part in the WOCCU Credit Union Strengthening project in Ecuador, which began in 1995 and ended in 2001.

The general characteristics of San Francisco and 23 de Julio credit unions are summarized in Table 7.1.

Table 7.1 Characteristics of San Francisco and 23 de Julio

	San Francisco	23 de Julio
Founding Date	May 20, 1962	August 20, 1964
Number of Operating Offices	4	6
Total Number of Employees	62	62
Number of Members	62,568	55,916
Total Assets (December 2001)	$9,094,006	$9,507,788
City	Ambato, Ecuador	Cayambe, Ecuador
Slogan	"Cooperative Financial Services"	"You Are Our Most Important Asset"
Requirements for Membership	$15 ($4 shares, $4.20 savings, $5 debit card, and $1.80 other)	$20 ($8 shares, $11.40 savings, and $0.60 other)

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Because of the changes implemented by both credit unions during this institutional strengthening program, they have developed a capacity to react to changes in the market and an ability to sustain continued growth. Savings mobilization was a key element in the institutional strengthening program. San Francisco made important and pioneering innovations to mobilize savings. 23 de Julio took advantage of the positive reputation that it already enjoyed in the local market to expand its savings programs.

The Setting in Ecuador

Three environmental conditions affected the savings mobilization strategies implemented by San Francisco and 23 de Julio. Those conditions were: the economic environment, the status of the financial system, and the legal framework for credit unions in Ecuador. A look at savings in the credit union system in Ecuador as a whole will enable us to appreciate the growth the two institutions achieved.

Economic Environment

The economic environment of Ecuador during the final decades of the twentieth century could be described as "an economy of mistrust," with all of its resulting consequences. During the 1980s, economic turmoil resulted in inflation, institutional disorganization, a decrease in real income, and the deeper impoverishment of a large part of the population. The government's printing of money to cover excesses in public spending resulted in consistently high levels of inflation and currency devaluation.

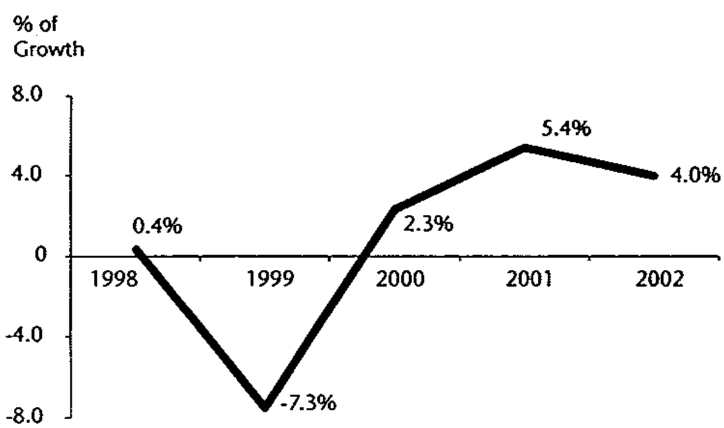
At the institution level, poor financial management of borrowed funds caused international investors and lenders to slow down and eventually shut off financing to Ecuadorian institutions. In 1998, many banks and finance companies in Ecuador went bankrupt. The continued devaluation of the local currency caused most individuals to invest in and depend on the dollar as a strong currency. Banks invested almost 70 percent of their portfolios in dollars. As a result, by 1999 Ecuador's economy was experiencing a *de facto* dollarization.

In March 1999, the government imposed temporary bank closings and a freeze on deposits. These actions further increased the level of public mistrust of the financial system. People distanced themselves from the formal financial system. Instead, they used what could be called "mattress banking" (hiding money in the house). By year-end 1999, 15 of the country's 38 banks had failed, and four of those 15 were taken over by the government. One of the banks that closed its doors in mid-2001 had been the largest bank in the country.

The exchange rate plummeted from 6,800 sucres per U.S. dollar in January 1999 to 19,000 sucres per U.S. dollar in December of that year. On January 10, 2000, when official dollarization was announced, the exchange rate was 25,000 sucres per U.S. dollar.

In the two years following dollarization (as of this writing), macroeconomic indicators have improved. Figure 7.1 shows the changes in Ecuador's GDP from 1998 through midyear 2002. In 1998, Ecuador's GDP had stagnated, showing a mere 0.4 percent growth. In 1999, GDP declined 7.3 percent. Growth resumed in 2000. In 2001 the Ecuadorian economy experienced the greatest percentage growth in GDP in Latin America at 5.4 percent. Inflation was 60.7 percent in 1999 and 91 percent in 2000. By 2001, inflation had decreased to 22.4 percent. Interest rates on loans have decreased, from an average of 22 percent to 16 percent in February of 2002. The minimum living wage and complementary compensation were $49 per month in December 1999. These wages increased to $98 in December 2000 and to $121 in December 2001.

Figure 7.1 GDP Growth in Ecuador



Source: Central Bank of Ecuador.

Status of the Financial System

Table 7.2 illustrates the growth trends in financial institutions from 1999 through 2001. The growth levels of the 26 regulated credit unions during 2000 and 2001 were the highest among the financial institutions of Ecuador. Total credit union assets grew during those two years by 250 percent; the net loan portfolio and the total savings deposits grew by more than 300 percent.

The asset levels of the 26 regulated credit unions fell and then recovered. In December 1998, assets totaled $147 million. Assets fell to $75 million in December 1999, a decrease of 49 percent, due to the

Table 7.2 Main Variables of Financial Institutions in Ecuador

	Dec 1999	Dec 2000	Difference %	Dec 2001	Difference %
Total Assets					
Credit Unions[1]	74.7	99.2	32.8	184.5	86.0
Banks[2]	5,403.3	4,493.4	– 16.8	4,429.0	– 1.4
Finance Companies	221.7	238.2	7.4	307.8	29.2
Mutuals	57.1	64.7	13.3	118.5	83.2
Net Loans					
Credit Unions[1]	38.6	66.7	72.8	124.5	86.7
Banks[2]	2,375.3	1,859.0	– 21.7	2,080.1	11.9
Finance Companies	105.3	152.1	44.4	207.8	36.6
Mutuals	19.7	25.6	29.9	64.0	150.0
Deposits					
Credit Unions[1]	35.2	61.2	73.9	118.9	94.3
Banks[2]	2,632.1	2,807.7	6.7	3,226.3	14.9
Finance Companies	131.8	129.1	– 2.0	162.7	26.0
Mutuals	31.5	42.5	34.9	80.8	90.1

In millions of U.S. dollars.

[1] *Twenty-six credit unions regulated by the Superintendency of Banks.*

[2] *For 2000 and 2001 the figures represent only private banks still in operation.*

Source: Bank Superintendency of Ecuador.

currency devaluation. Yet the credit unions recovered quickly. In only two years, the value of assets exceeded 1998 levels, and, as of December 2001, total assets had reached $184.5 million. This recovery was based on a sustained increase in savings. After decreasing from $69 million in December 1998 to $35 million in December 1999 with the currency devaluation, savings reached $119 million in December 2001.

The capacity of the credit unions to withstand and react to the financial crisis strengthened their competitive market positions compared to other financial institutions. Table 7.3 compares four types of financial institutions in Ecuador—credit unions, banks, finance companies, and mutuals. Credit unions and mutuals have the lowest delinquency rates, at 3.3 and 3.9 percent, respectively. All of the institutions have adequate levels of liquidity. Portfolio performance is better in credit unions, mainly due to prudent financial management and delinquency control. Credit unions have stronger capital positions—with equity of 30 percent of total assets—than banks, finance companies, or mutuals.

Table 7.3 Primary Indicators of Financial Institutions in Ecuador

Indicators	Credit Unions[1] %	Banks[2] %	Finance Companies %	Mutuals %
Delinquency / Total Portfolio	3.9	7.2	9.0	3.3
Non-earning Assets / Total Assets	18.9	19.4	16.4	15.6
No-cost Funds / Non-earning Assets	179.6	95.8	268.3	174.7
Liquidity	22.9	35.7	23.4	24.6
Income / Average Assets	1.2	1.6	1.4	2.8
Total Expenses / Average Assets	11.8	7.8	13.8	12.4
Return on Portfolio	20.0	15.9	13.2	18.3
Financial Cost of Deposits	4.5	3.9	7.8	4.6
Equity / Total Assets	30.4	10.4	11.2	21.2
External Credit / Total Assets	1.6	7.1	2.8	4.6

[1] *Twenty-six credit unions regulated by the Superintendency of Banks.*
[2] *Figures represent only private banks still in operation.*
Source: Bank Superintendency of Ecuador.

Legal Framework for Credit Unions

Two laws regulate credit unions in Ecuador. The General Law of Institutions of the Financial System, passed in 1994, and its bylaws regulate all businesses that perform financial intermediation. The Credit Union Law of 1964 and its Rules for the Constitution, Organization, Operations, and Liquidity of Credit Unions that Perform Financial Intermediation with the General Public, issued through Executive Decree 1227 in March 1998, apply to credit union operations. In December 2001, Executive Decree 2132 was issued to replace Decree 1227 and establish a new regulatory framework for credit unions.

The new law resulting from Executive Decree 2132 broadens the scope of the Bank Superintendency, identifies credit unions that raise savings as financial intermediaries to be regulated, facilitates mergers, authorizes credit unions to accept deposits from third parties (non-members), stipulates a maximum rate of up to 15 percent for loans to third parties, authorizes operations according to capital levels, and establishes an institutional capital minimum of $200,000 for the establishment of new credit unions.

Savings in the Credit Union System

In October 2000, in the provinces where regulated credit unions operated, banks mobilized $1,438 million in savings, while the 26 regulated credit unions mobilized $96.5 million in savings (in passbook and fixed-term deposits). In other words, for every $100 of savings mobilized by banks, the credit unions raised $6.70.

If we analyze the situation differently, we can determine the market share of credit unions in the outer provinces, where fewer banks are located. Excluding the two largest provinces of Guayas and Pichincha, in which the two largest cities in Ecuador and various bank headquarters are located, we find that the credit unions mobilized $49.3 million in savings while banks mobilized $202.2 million. In other words, credit unions mobilized $24.30 in savings for every $100 mobilized by banks in the outer provinces.

This comparison reveals that the credit unions have a stronger presence and greater market penetration in the outer provinces. Banks have a stronger presence in Guayas and Pichincha, where 30 percent of the Ecuadorian population lives, because of the more sophisticated demand for financial services and the larger corporate presence. Table 7.4 compares the relative deposits in credit unions and banks in Ecuador in January 2000, November 2000, and October 2001. This table demonstrates that the market share of the regulated credit unions increased substantially in relation to banks, doubling in less than two years.

Table 7.4 Relative Deposits in Credit Unions and Banks in Ecuador[1]

	Jan 2000	Nov 2000	Oct 2001
In Provinces where regulated Credit Unions Operate			
Banks	100.0	100.0	100.0
Credit Unions	3.3	4.0	6.7
Excluding Provinces of Pichincha and Guayas			
Banks	100.0	100.0	100.0
Credit Unions	12.5	13.3	24.3

[1] *Passbook and fixed-term savings.*

A survey performed by WOCCU in September 2001 found that there were 332 credit unions operating in Ecuador. Of these 332 credit unions, 26 were regulated by the Bank Superintendency. The data in Table 7.4 describes these 26 regulated credit unions. If we add the deposits mobilized by the 306 unregulated credit unions, approximately $90 million, the total savings raised by credit unions in Ecuador was approximately $150 million as of December 2000.

Meeting the Institutional Preconditions

When the project began, San Francisco and 23 de Julio had been receiving some savings, but they both faced conditions that required strategic responses if they were to mobilize increased levels of savings.

Legal Issues

Credit unions in Ecuador have the legal authority to mobilize savings and to set interest rates for savings and loans. The law limits the maximum interest rates that can be charged on loans. If institutions require additional loan income, however, the law does allow them to charge fees on credit operations. Accounting procedures are standardized according to the chart of accounts provided by the Bank Superintendency.

Financial Management

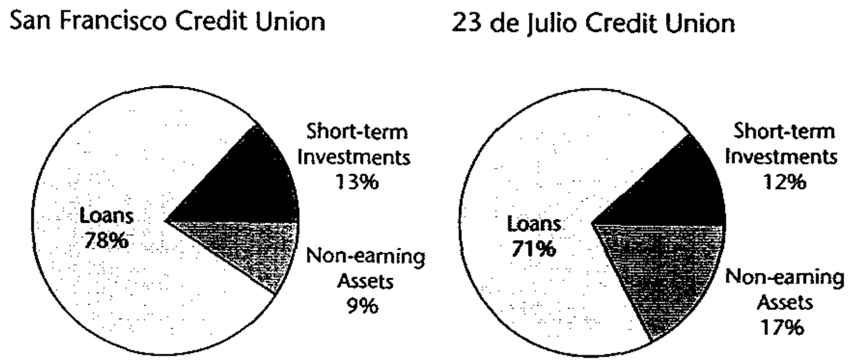
Asset quality. The delinquency rate in December 2001 was 0.18 percent at San Francisco (the lowest in the credit union system in Ecuador) and 1 percent at 23 de Julio. Credit risk assets are assessed on a quarterly basis to establish the necessary provisions for loan losses. As of December 2001, both credit unions had provisions for 100 percent of loans delinquent for one to nine months and for 100 percent of those that were delinquent more than nine months.

Liquidity management. Both credit unions maintain more rigorous internal standards for liquidity management than the 14 percent minimum required by law. As of December 2001, San Francisco managed a minimum liquidity of 18 percent and 23 de Julio maintained liquidity between 18 and 22 percent. (Liquidity equals the liquid assets minus the short-term payables divided by the total deposits.) Committees manage assets and liabilities in both credit unions. Savings and loans are evaluated on a weekly basis to ensure that the correct match is maintained. Cash flow reports are created regularly and used as decision-making tools.

Financial structure. The composition of total assets demonstrates the financial specialization of San Francisco and 23 de Julio. As of December 2001, more than 70 percent of their assets were invested in loans. Both credit unions still maintained high levels of non-earning assets, particularly 23 de Julio, where 17 percent of total assets were non-earning. The high level of non-earning assets was not caused by an increase in fixed assets, but was due to the revaluation of fixed assets as required by law. Figure 7.2 compares asset distribution in San Francisco and 23 de Julio credit unions.

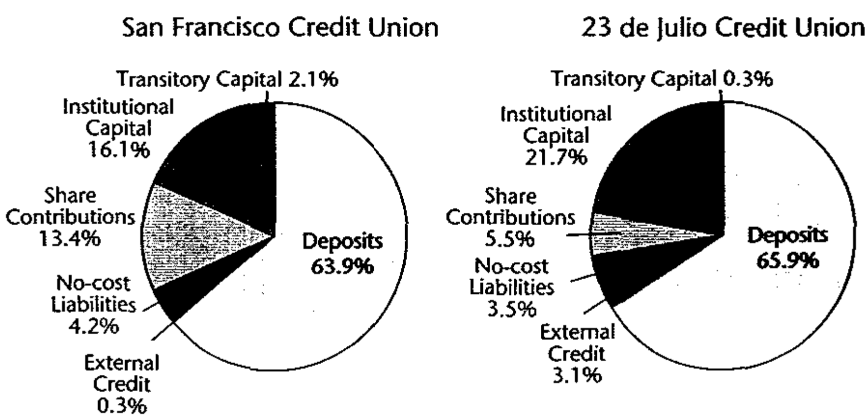
Both institutions finance assets largely through savings deposits. As of December 2001, the ratio of deposits received to total assets exceeded 63 percent in both credit unions. External credit as a percentage of total assets was 0.3 percent in San Francisco and 3.1 percent in 23 de Julio. Member share contributions were equal to 13.4 percent of total

Figure 7.2 Asset Distribution in San Francisco and 23 de Julio



assets in San Francisco and 5.5 percent of total assets in 23 de Julio. Both credit unions maintained high levels of institutional capital. San Francisco had institutional capital equal to 16.1 percent of total assets and 23 de Julio had 21.7 percent as of December 2001. The strong capital position represented a solid basis of solvency and sustainability for the long term. Figure 7.3 illustrates the asset financing in both institutions.

Figure 7.3 Asset Financing in San Francisco and 23 de Julio



Market Viability

Marketing activities are essential in both credit unions. Managers in the two institutions have taken different approaches to marketing. At 23 de Julio, the marketing department, established in 1998, conducts market research, creates campaigns, and runs promotions. In January 2002, the marketing director began to focus exclusively on marketing. (Before 2002, the director had been assigned other duties as well). San Francisco hired a specialized firm to conduct its marketing activities. This firm receives its direction from an internal working group at San Francisco made up of officers from different areas in the credit union. Both credit unions have defined their competition as commercial banks, other regulated and unregulated credit unions, finance companies, mutuals, informal moneylenders, and stores that offer consumer credit.

A WOCCU survey in July 1999 found that the majority of credit union members were young: 58 percent of the membership was 25 to 44 years old. Thirty-eight percent of the members were women. The savers in San Francisco and 23 de Julio had the average age of 40 years old.

The survey indicated that 57 percent of members in San Francisco and 47 percent in 23 de Julio worked in informal microenterprises. In both credit unions, 33 percent of members stated that they worked as salaried employees or had a defined microenterprise activity.

The principal income-generating activities in the city of Ambato, where San Francisco is located, are production of leather and leather accessories. Forty-seven percent of people interviewed worked in this industry.

In the city of Cayambe, home to 23 de Julio, flower production is the main activity. The other main income-generating activities were in flower supply, dry goods, and clothing stores.

As of this writing, neither credit union had record-keeping systems such as databases that could provide updated membership profiles, market penetration statistics, or other information required to design specific marketing strategies.

Changes in Image

Both credit unions entered into a process of strengthening their institutional images. Through remodeling and reorganizing their offices, changing policies to offer competitive financial services, and creating corporate images that included new logos and the standardization of corporate colors, the credit unions transformed their image to one of professional financial intermediaries. The credit unions also improved the quality of their client services. Despite the economic and political instability of Ecuador, the credit unions devised ways to consistently present images of safety and soundness.

In addition to an improved image, the institutions have found that sound financial management was fundamental to achieving the trust of clients and securing their deposits. Juxtaposed with the financial weakness of the banking system, the positive image and financial strength enabled the credit unions to position themselves as the safest savings institutions in Ecuador.

Human Resources

Two factors were essential to strengthening these institutions: the establishment of clear roles and responsibilities and the professional training of credit union personnel. Managers are now responsible for the daily administration of the institutions. The boards of directors and the directive committees have been flexible in the face of change, defining their roles more as the governing and oversight authorities of the institutions. Staff members have received training in customer service and different areas of operations.

Marketing Improvements

From marketing strategies based only on printed brochures, the credit unions have grown into organizations with broader perspectives and sophisticated marketing strategies. They now focus on providing clients with high-quality services that satisfy their basic financial needs. With better marketing and a stronger client focus, the credit unions have earned reputations as specialized financial institutions of high quality.

Instituting Financial Discipline

The following elements were critical in the implementation of financial discipline:

- Professional training of personnel and directors;
- Use of an adequate chart of accounts for the correct identification of accounts;

- Supervision and regulation by the Bank Superintendency;
- A fundamental change in attitude, with a focus on financial discipline; and
- Directors and managers who were flexible, making changes when needed.

Competition and Market Potential

The cities where San Francisco and 23 de Julio are located, Ambato and Cayambe, respectively, are characterized by intense competition among financial institutions. Table 7.5 summarizes the competitive environment in Ambato and Cayambe.

Table 7.5 Competitive Environment in Cayambe and Ambato

	Banks	Mutuals	Finance Companies	Regulated Credit Unions	Unregulated Credit Unions
1998					
Cayambe	7	1	0	1	no data
Ambato	16	1	3	3	no data
2001					
Cayambe	3	1	0	1	1
Ambato	11	1	2	3	15

Source: Bank Superintendency of Ecuador and WOCCU National Survey of Credit Unions.

In Ambato, where there were three regulated credit unions, statistics as of December 2001 showed that San Francisco had 30 percent of the total credit union membership and 26 percent of total assets. There were 11 banks, one mutual, and 15 unregulated credit unions also operating in that market. In Cayambe, on the other hand, 23 de Julio did not compete with other regulated credit unions, but faced competition from three banks, a mutual, two finance companies, and one unregulated credit union.

There was also competition in the towns where San Francisco and 23 de Julio have branches. In El Puyo, where San Francisco has a branch, there was one bank and two unregulated credit unions. In Otavalo, where 23 de Julio has a branch, there were two banks, one other regulated credit union, and at least six unregulated credit unions.

Savings Mobilization

As part of the credit unions' programs to increase deposits, old policies were updated and new policies were instituted. The new policies were based on strategies to differentiate the savings services offered by the credit unions from those of other financial institutions. Emphasis was also placed on implementing financial management and internal control policies and procedures to protect savings.

Policies to Facilitate Savings Mobilization

The following policies were key to the savings mobilization strategies in both credit unions:

- Interest rates were not used as marketing tools, but instead were established according to prevailing market rates and technical criteria to cover all costs.
- Strict financial disciplines were maintained and publicized to demonstrate stability and to generate trust among members of the community.
- Marketing activities were given a high priority.
- The institutions increased their public identification as financial intermediaries.
- Risks were identified and steps were taken to manage them.
- Investments and loan portfolios were diversified.

Interest rates. In both credit unions, gaining the trust of the community was the underlying element in their savings mobilization programs. Interest rates were considered secondary elements in attracting savers. According to policy introduced as part of its strengthening program, San Francisco decided to pay interest according to market rates on average passbook accounts. 23 de Julio paid interest according to a rate scale based on account balances. Both credit unions offered competitive rates, but adopted savings strategies that were based on high-quality service to differentiate themselves from the competition. Interest rates on fixed-term deposits varied according to the account balance, term, and market rates.

Both institutions focused on passbook accounts as their main savings products, considering fixed-term deposits to be of higher volatility than demand savings. At San Francisco, the new rate-setting policy for both savings and loans stipulated that the finance committee, made up of professional staff, would set the rates, with subsequent approval by the board of directors. At 23 de Julio, the board of directors became more involved in setting interest rates, based on reports provided by management.

Specific Strategies Employed

Each credit union applied specific strategies suited to its local market characteristics and according to its technical capacity.

Policies adopted by San Francisco. This section lays out some of the steps San Francisco took to ensure that it would be a secure financial intermediary able to protect savings. It also presents some of the progressive services San Francisco offers to mobilize increased savings.

- Liquidity management is considered a fundamental tool of operation, in addition to a regulatory requirement. The credit union's strict policy of maintaining 18 percent of deposits provides stability to the savings program.
- Increased hours of operation include Saturdays, Sundays, and holidays. San Francisco is open Monday to Friday from 8:00 a.m. to 7:00 p.m., and on weekends and holidays from 9:00 a.m. to 3:30 p.m. This strategy gives clients increased access to their deposits and, in the words of San Francisco directors, "has been fundamental for improving the savings activity." As of 2002, San Francisco is the only financial institution in Ambato open on Sundays and holidays.
- Limits on savings withdrawals were abolished. Clients now have unlimited access to their demand deposits.
- Loans are disbursed through deposits into savings accounts instead of by checks. This allows some of the loan funds to remain in the credit union as savings, since not all of the members withdraw the entire loan amount at once.

- The credit union has a new logo and also made improvements to its physical and corporate images. From an institution that the population considered a "good credit union," it has earned a reputation for being a "quick and innovative financial institution."
- San Francisco redesigned savings products to attract net savers. Loans are no longer the primary reason for joining the credit union. It has moved from a growth strategy based on obligatory savings leveraged to access loans to one based on voluntary savings offered as one of many financial services.
- Creation of the *Efecti-ahorro* provides members with withdrawal slips similar to checks that they can use to make purchases at businesses with which the credit union has signed agreements. This product is linked to an automatic line of credit in order to guarantee payment to the stores.
- Publicity and promotions such as "scratchers"—a ticket given for set deposit amounts where instant prizes are awarded—are used as a marketing strategy. The promotions are publicized through newspapers, brochures, posters, banners, bus stop signs in the city, and on the radio with a recognizable jingle.
- Temporary promotions are conducted, such as: "Bring your passbook today and get credit tomorrow." For this promotion, clients bring a savings passbook from another institution to show the credit union how they have managed their accounts. Those who transfer their savings to the credit union are eligible for credit after a short time.
- A strategic alliance with a private bank allows the credit union to offer debit cards that function throughout the ATM network in Ecuador and throughout the world with Visa Plus™. With this service, San Francisco has been able to attract increased savings deposits. In addition to increasing membership, the ease of withdrawal has prompted existing members to transfer money they had saved in other institutions to the credit union. All new members receive a debit

card, and debit cards have been offered to all existing members.

- Strong liquidity management enables the credit union to avoid unscheduled closings, which can shake member confidence.
- San Francisco uses a digital signature to identify each member. This enables the credit union to provide high-quality personalized member service.
- All credit union branches are part of the real-time computer network. This means that members do not have to wait long periods for transactions to be processed.

Policies adopted by 23 de Julio. This section lists some of the steps 23 de Julio took to ensure that it would be able to protect savings. It also presents some of the progressive services 23 de Julio offers to mobilize increased savings.

- The credit union has been able to build on its stable 35-year presence in the market and utilize its positive reputation to attract new members during the banking crisis.
- Because member surveys and financial analysis showed that 90 percent of the members joined for access to savings services, 23 de Julio's efforts to maintain and build member trust in the institution are fundamental. The credit union's marketing emphasizes this trustworthiness to position its brand in the local market.
- Interest rate management, although not a strategy used to attract savings, is important in this market. In Cayambe, saver profiles indicate that savers seek institutions that will pay competitive rates—better rates than those paid by other local institutions.
- 23 de Julio redesigned its physical appearance to improve its professional image. The credit union created a new logo to promote the revitalized image.
- The headquarters office was relocated near the city's central park. 23 de Julio is the only financial institution in this prime location.

- To encourage savings, the credit union conducts temporary promotions to offset the cyclical exit of money, especially in November and December. Prizes are awarded to winners in proportion to the average balances of their savings accounts during a certain period that includes these months.
- 23 de Julio offers a payroll administration product based on agreements with businesses, especially the flower growers. Paychecks are deposited directly into savings accounts at the credit union.

Protection of Deposits

The deposit protection strategies adopted by the two credit unions are summarized in the lists that follow. These strategies were ongoing at the time of this writing.

Although both institutions have deposit insurance from the *Agencia de Garantía de Depósitos* (Agency for Deposit Guarantees) of the Ecuadorian government, they do not market this insurance to their members. Instead, they market their own financial strengths and institutional stability to gain and maintain the trust of savers. Managers at both institutions believe that openly publicizing the government deposit insurance would be counterproductive after the banking crisis, since clients might relate this insurance to financial weakness.

In addition to the deposit insurance, both credit unions protect their deposits through financial management that adheres to strict disciplines.

- Liquidity management is key. The law requires a minimum of 14 percent; the credit unions maintain higher standards.
- Credit is diversified by the type of collateral, amount granted, and income-generating activities of the borrower (microenterprise, agriculture, commerce, consumption, or transportation, for example).
- Thorough credit evaluation is conducted using the *Ratios2000* system from WOCCU. The *Ratios2000* system is based on the five C's of credit: character, credit history, capacity to repay, collateral, and condition.
- Sound analysis of investment institutions is ongoing.
- Diversification of investments is a priority.
- Delinquency is rigorously monitored and controlled.

Product Development

In order to determine the needs of current and potential clients, both credit unions carried out surveys. San Francisco hired a specialized firm to conduct the survey; the new marketing director at 23 de Julio performed its survey. The survey results showed that people expected unlimited access to their deposits and they wanted their credit unions to provide more sophisticated financial services. In response to the findings, the credit unions developed new products tailored to their local market expectations and the technological facilities available. Table 7.6 lists the products and services introduced as a result of these surveys.

Each credit union developed five savings products. Each product has unique characteristics to serve savers with varying demands. These products are described in Table 7.7 and Table 7.8.

Table 7.6 Products and Services Offered by San Francisco and 23 de Julio

Savings	Credit	Financial Services
San Francisco		
Demand Savings	Collateral	Transfers (Western Union)
Fixed-term Deposits	Line of Credit	Payment for Basic Services
Efecti-ahorro	Housing	Repayment Insurance
Panchito Account	Clinic/Hospital	VISA PLUS Debit Card
Share Certificates	Automatic	Automatic Tellers
	For Stores	Electronic Administrator
	Letters of Credit	
	Purchase of Portfolio	
	Pre-approval	
23 de Julio		
Demand Savings	Collateral	Transfers (Western Union)
Fixed-term Deposits	Microenterprise	Payment for Basic Service
Mi Cuenta Mágica	Open Line of Credit	Repayment Insurance
Payroll Administration		VISA PLUS Debit Card
Share Certificates		

Table 7.7 Characteristics of Savings Products in San Francisco

Product	Characteristics	Marketing
Passbook Account	• Withdrawals can be made with the savings passbook, debit card, or *Efecti-ahorro* • Anyone who opens a passbook becomes a member • Obligatory debit card for new members • Minimum balance to open the passbook account: $15, includes shares and debit card costs • No account maintenance charges	• Service 365 days of the year, including weekends and holidays • Access to the network of ATMs throughout the country and the world • Publicity in print media and on the radio • Offices on real-time network • Convenience of unlimited withdrawals at teller windows • Temporary promotions: "Scratchers," "Bring your passbook today and get credit tomorrow"
Fixed-term Certificates of Deposit	• Deposits withdrawable upon maturity for terms no less than 30 days • Minimum investment level is $100 • Endorsable with prior notice to the credit union • May be liquidated before the maturity date, with a prior agreement with the credit union and a review of the agreed rate • Financial service officers are in charge of serving members with this type of investment	• Not marketed intensely because of volatile nature • Institutional publicity through print media and the radio • Competitive interest rates
Efecti-ahorro	• Demand savings • Check-like withdrawal slips that the member may use to pay for goods and services • Agreements with different stores and service stations • Automatic line of credit for up to $400 • Minimum opening balance of $15 • Passbook provided for account	• Publicity in print media and on the radio • Banners and signs • Marketing of establishments that have agreements with the credit union • Marketing of the system as a means of payment • Security and support for beneficiaries through the automatic line of credit

Table 7.7 continued Characteristics of Savings Products in San Francisco

PRODUCT	CHARACTERISTICS	MARKETING
Panchito Account	• Youth passbook savings • Directed to minors (up to 18 years old) • According to law, they may not be members of the credit union; they are considered third parties • Minimum opening balance of $8 • The debit card is optional and has an additional cost of $5 • No maintenance charges • Withdrawals made through an accredited representative • Special passbook	• Publicity in print media and on the radio • Passbook designed for children • Mascot • Student scholarships • Special gifts on certain days • Events for children • Vacation camps • T-shirts for children's soccer teams • Slogan: "Linked to the future"
Share Certificates	• Accredits depositor as a member • Annual return based on surplus	• Low minimum opening balance • No required course on the credit union before depositing shares • Fast and easy to become a member

Results

In 2001, both credit unions increased the number and volume of deposits received. San Francisco grew 113 percent and 23 de Julio grew 91 percent over the previous year, with total assets of $5.8 million and $6.2 million, respectively. Considering that the inflation rate was 22.4 percent, both credit unions achieved real positive growth in deposits: San Francisco grew 90.6 percent and 23 de Julio grew 68.6 percent. In only two years, San Francisco achieved a growth of 500 percent in deposits, from $1.1 to $5.8 million. During that same period, 23 de Julio increased savings 300 percent, from $1.9 to $6.3 million. The growth of both credit unions is shown in Figure 7.4.

Table 7.9 shows the savings growth of the two institutions from another perspective. In order to demonstrate the evolution of deposits from the year 1996 to 2001, growth was indexed, using the base year of December 1999 = 100. Thus, the table shows what happened before dollarization and how the credit unions regained territory in 2000 and 2001.

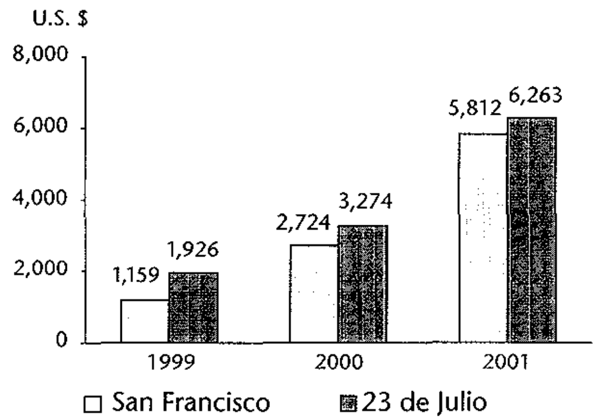
Table 7.8 Characteristics of Savings Products in 23 de Julio

Product	Characteristics	Marketing
Passbook Accounts	• Withdrawals through the use of the savings passbook • Minimum opening balance of $20, including shares • No maintenance charges	• Image of security and trust • Publicity in print media and on the radio • Temporary promotions based on account balances
Fixed-term Certificates of Deposits	• Demandable deposits upon maturity in a term no less than 30 days	• Not marketed intensely because of volatile nature • Institutional publicity in the print media and on the radio • Competitive interest rates
Mi Cuenta Mágica	• Youth demand savings account • Directed to minors (up to 18 years old) • According to law, youth may not be members of the credit union; they are considered third parties • No maintenance charges • Special passbook	• Passbook designed for children • Mascot • Promotions to increase balances • Visits to schools • Events for children • Delivery of materials to schools
Payroll Administration	• Payment of wages to employees of the company through the crediting of savings accounts • Agreement with the interested company	• Visits to businesses • Possibility of advancement of wages • Security and speed • Ease for employer
Share Certificates	• Accredits depositor as a member • Annual return based on surplus	• Low minimum opening balances • There is no prior course on the credit union required • Fast and easy to become a member

San Francisco recovered quickly from the currency devaluation in 1999; by December 2000 it had reached the level of savings it had in 1998. By December 2001, the level of deposits in San Francisco exceeded all previous years. Despite the banking crisis and dollarization, the credit union was able to mobilize increased levels of savings.

In the case of 23 de Julio, despite deposits having tripled since December 1999, it had still not reached previous levels by late December 2001, although it came close. The year 2001 was the second best year of the seven years of the index, and at the time of this writing it is expected

Figure 7.4 Growth of Deposits in San Francisco and 23 de Julio



that by December 2002, 23 de Julio will recover and exceed its historic deposit levels.

In terms of savings structure, San Francisco had 17 percent of its deposits in fixed-term accounts in 1999, which decreased to 7 percent in 2000, and 4 percent in 2001. This decrease reflects the credit union's lack of marketing of this product. Despite an increase from 11 percent in 1999 to 15 percent in 2001, fixed-term deposits at 23 de Julio did not represent a significant portion of total savings.

At 23 de Julio, as of December 2001, 94 percent of its 55,916 accounts were passbook accounts, amounting to 82 percent of all

Table 7.9 Indexed Savings Growth in San Francisco and 23 de Julio

Year	San Francisco	23 de Julio
December 1995	207.8	301.8
December 1996	197.1	291.3
December 1997	311.1	408.8
December 1998	220.3	230.8
December 1999	100.0	100.0
December 2000	235.0	170.0
December 2001	501.5	325.2

savings. The youth passbook account, *Mi Cuenta Mágica,* represented 4.2 percent of the total number of accounts and 2 percent of total savings volume. The new Payroll Administration product accounted for 1.4 percent of accounts. A breakdown of accounts was not available for San Francisco.

Table 7.10 shows the size of passbook accounts at the two credit unions. Most accounts—73 percent in San Francisco and 82 percent in

Table 7.10 Passbook Account Ranges in San Francisco and 23 de Julio[1]

Account Size in U.S. $	Savings[2]	% of Total	No. of Accounts	% of Total
San Francisco				
0 – 100	427,000	7.7	45,400	72.6
101 – 300	836,000	15.0	8,597	13.7
301 – 500	733,000	13.2	3,491	5.6
501 – 1,000	1,119,000	20.1	2,984	4.8
1,001 – 3,000	1,434,000	25.7	1,702	2.7
3,001+	1,020,000	18.3	394	0.6
Total	**5,569,000**	**100.0**	**62,568**	**100.0**

Account Size in U.S. $	Savings[2]	% of Total	No. of Accounts	% of Total
23 de Julio				
0 – 100	552,000	10.4	45,807	81.9
101 – 300	1,028,000	19.4	5,962	10.7
301 – 500	686,000	12.9	1,810	3.2
501 – 1,000	966,000	18.2	1,436	2.6
1,001 – 3,000	1,119,000	21.1	743	1.3
3,001+	947,000	17.9	158	0.3
Total	5,297,000	100.0	55,916	100.0

[1]*As of December 2001.*

[2]*In U.S. dollars rounded to the nearest whole thousand.*

23 de Julio—had balances of less than $100. These small accounts represented only 7.7 percent at San Francisco and 10 percent at 23 de Julio of total savings volume. This account distribution reflects the socio-economic characteristics of the Ecuadorian population, where 80 percent of wage earners earn less than $500 per month, and more than 50 percent earn less than $300 per month. It is important to note that 46 percent of the total volume of savings mobilized by San Francisco and 39 percent by 23 de Julio had balances between $500 and $3,000, constituting only 8.1 and 4.2 percent of the total number of accounts, respectively.

Savings transferred from other financial institutions has fueled the growth of credit unions throughout Ecuador. Table 7.11 shows the movement of funds to credit unions from other financial institutions.

Table 7.11 Relative Deposits in Credit Unions and Banks in Ambato and Cayambe[1]

	Jan 2000	Nov 2000	Oct 2001
In Ambato			
Banks	100.0	100.0	100.0
Credit Unions	8.2	8.4	14.9
In Cayambe			
Banks	100.0	100.0	100.0
Credit Unions	80.0	82.3	230.0

[1] *Passbook and fixed-term savings.*

At the time of writing, there were 11 banks and three regulated credit unions operating in Ambato. The regulated credit unions had a strong presence in the market, attracting $15 for every $100 received by banks.

Table 7.12 shows the market penetration of San Francisco's three branches. In October 2001, San Francisco had a 4 percent market share in passbook and fixed-term savings in the province of Tunguragua, where credit unions controlled 25 percent of the market. The situation was different in Pastaza province, where San Francisco's branch in the city of El Puyo had 33 percent of the market, compared to the local

Table 7.12 Market Penetration of San Francisco Branches[1]

	Tungurahua		Pastaza		Cotopaxi	
Financial Institution	Savings[2]	% of Total	Savings[2]	% of Total	Savings[2]	% of Total
San Francisco	3,091,000	4.1	1,026,000	32.8	1,274,000	7.5
Banks	57,177,000	75.4	601,000	19.2	10,228,000	0.6
Other Regulated Credit Unions	10,383,000	13.7	–	0.0	4,393,000	0.3
Unregulated Credit Unions[3]	5,153,000	6.8	1,501,000	48.0	1,200,000	0.1
Total	75,804,000	100.0	3,127,000	100.0	17,095,000	1.0

[1] *Passbook savings and fixed-term deposits as of December 2001.*

[2] *In U.S. dollars rounded to the nearest whole thousand.*

[3] *WOCCU, National Credit Union Survey. Data as of Dec 2000. 92% of savings are considered.*

Source: Bank Superintendency, Bulletin of Deposits and Investments.

bank's 19 percent. In Cotopaxi province, San Francisco had a branch in the city of Salcedo but not in Latacunga, the capital of the province. In Cotopaxi, the credit union held a market share of 7.5 percent.

In Cayambe, where only 23 de Julio and three private banks offered savings services, the credit union received $230 for every $100 deposited in banks by October 2001. In 1999, 23 de Julio had received only $80 per $100.

Table 7.13 shows the market penetration of 23 de Julio's five branches. 23 de Julio had 70 percent of the market in the city of Cayambe. In Otavalo, where the banks had 78 percent of the passbook and fixed-term savings market, 23 de Julio held 7.8 percent. Together, the market share of the other regulated credit unions and the unregulated credit unions totaled 15 percent in Otavelo.

Lessons Learned

Both San Francisco and 23 de Julio have become market leaders. They achieved their success through use of service differentiation strategies and professional image building. San Francisco based its strategy on innovation, image, ease of access, and liquidity. 23 de Julio based its strategy on trust, market positioning, and security.

Table 7.13 Market Penetration of 23 de Julio Branches[1]

	Cayambe		Otavalo	
Financial Institution	Savings[2]	% of Total	Savings[2]	% of Total
San Francisco	2,248	70.0	829	7.8
Banks	964	30.0	8,272	77.6
Other Regulated Credit Unions	–	0.0	648	6.1
Unregulated Credit Unions	–	0.0	900	8.5
Total	**3,212**	**100.0**	**10,649**	**100.0**

[1] *Passbook savings and fixed-term deposits as of October 2001.*
[2] *In U.S. dollars rounded to the nearest whole thousand.*

To increase savings mobilization, both credit unions found it was essential to provide services that allowed for easy withdrawal of money—through extended hours, unlimited teller withdrawals, debit cards for use at ATMs, and various points of sale, or through a combination of these.

To mobilize savings over the long term, the credit unions found it was necessary to establish long-term sustainability through strict financial disciplines, prudent financial management, and professional administration. To build trust among clients and mobilize increased savings, an institution must prudently manage its loan portfolio and investments, focusing on diversification, rotation, and the technical analysis of credit. If clients sense that an institution will put their deposits at risk, they will not save there.

Clients tend to trust and save more in institutions that present safe and sound images. Remodeling can help an institution create this image. Luxurious surroundings are not required, but the institution must be functional and secure. Standardizing the corporate image is key to creating brand identification.

Well-defined underlying strategies can provide the basis for a credit union's activities. For example, San Francisco has based its savings activities around liquidity management. 23 de Julio has focused on developing client trust through presentation of a safe and sound image.

Lowering the barriers to entry for new clients will facilitate savings mobilization. This means setting the opening balance at an amount in accordance with the target market and eliminating processes that slow the enrollment process. The evaluation of a client should happen when he or she applies for credit or opens a savings account. Cooperative education or savings education is something that is best learned through the use of the credit unions' financial services, rather than through required courses on the cooperative movement or attendance at admissions committee meetings.

Conclusion

This case study presented the activities of two credit unions in Ecuador: San Francisco, Ltd. and 23 de Julio, Ltd. The study described the specific strategies applied, the policies implemented, and the concrete results achieved in savings mobilization. These measures were successfully implemented in an unstable political and economic environment. The credit unions demonstrated that in order to mobilize savings as a main source of growth, it is necessary to maintain strict financial disciplines that result in adequate levels of capital, sufficient protection for risk assets, and appropriate liquidity levels. An institution can become a leader through the use of competitive pricing, or through differentiation—innovation, service, and positive public image. San Francisco and 23 de Julio both chose the differentiation route.

It is commonly said that crisis, together with its difficulties, brings opportunities. The two credit unions, San Francisco and 23 de Julio, did experience setbacks during the crisis; however, they not only maintained their stability, but also achieved significant levels of growth and consolidation in the market. These accomplishments were gained while other institutions were hanging signs that read "Closed for Operations." Savings mobilization was a fundamental component of the stabilization and growth achieved by San Francisco and 23 de Julio during times of crisis in Ecuador.

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CHAPTER 8 Ecuador: Savings Mobilization in 14 Credit Unions

Oswaldo Cabezas Paredes

This case study provides an overview of the savings strategies and practices implemented in 14 credit unions in Ecuador and presents data that demonstrate the success those institutions achieved in mobilizing savings. The study also establishes a savings profile of membership in the credit unions, based on individual surveys. This case study was the result of a formal investigation of savings mobilization implemented by the German Confederation of Credit Unions (DGRV) in November 2001, with the objective of contributing to the development of the credit union system of Ecuador.

At the time of the study, there were 332 active credit unions in Ecuador, according to a national survey performed by WOCCU. Of these, 26 were supervised by the Bank Superintendency. The remaining 306 were overseen by the National Committee on Credit Unions, commonly known as DINACOOP. According to the same survey, there were 1,481,428 credit union members in Ecuador as of September 2001.

Statistics about the 14 credit unions investigated in the study are presented in Table 8.1. Seven of the institutions were supervised by the Bank Superintendency; the other seven were supervised by DINACOOP. Eleven of the 14 credit unions were in the mountains, two were on the coast, and one was in the eastern part of the country. Eleven of the credit unions were urban, or located in town centers, and three were rural. According to the WOCCU national survey, the credit unions in this study had a total of 457,841 members, representing 30.9 percent of the total credit union membership in Ecuador.

In general terms, the three rural credit unions in the study experienced the greatest growth in savings. Their strategies were

Table 8.1 The 14 Ecuadorian Credit Unions in the Case Study[1]

Credit Union Supervised by	Number of Members	Savings Deposits[2]	Loans[2]
Bank Superintendency			
La Nacional	95,703	13.3	8.9
Cooprogreso	68,494	8.2	8.7
San Francisco	61,824	5.5	6.6
23 de Julio	55,525	5.8	6.8
Riobamba	27,852	6.4	7.7
Chone	20,724	1.2	2.3
CACPECO	19,542	2.8	3.1
DINACOOP			
MEGO	51,727	18.5	15.1
Cacpe Pastaza	20,366	2.2	2.7
Jardín Azuayo	14,977	4.4	5.4
Mushuc Runa	11,200	1.6	1.9
Chuchuqui	4,102	0.5	0.5
Cacpe Biblián	3,387	1.8	2.0
Unión El Ejido	2,418	0.3	0.4
Total	**457,841**	**72.7**	**72.0**

[1] *As of October 2001.*
[2] *In millions of U.S. dollars.*

based on the development of a social and cultural identity, with an emphasis on solidarity among members, who were largely indigenous peoples and farmers.

Table 8.2 consolidates data to compare the seven credit unions supervised by the Bank Superintendency with the seven supervised by DINACOOP, as measured by their number of members, total deposits, and loan portfolios. As Table 8.2 demonstrates, the seven credit unions supervised by the Bank Superintendency had a larger share of the market than the seven supervised by DINACOOP.

Table 8.2 Size of 14 Credit Unions Supervised by the Bank Superintendency and DINACOOP[1]

Credit Unions Supervised by	Number of Members	%	Savings Deposits[2]	%	Loans[2]	%
Bank Superintendency	349,664	76.37	43.3	59.53	44.1	61.16
DINACOOP	108,177	23.63	29.4	40.47	28.0	38.84
Total	457,841	100.00	72.7	100.00	72.0	100.00

[1] *As of October 2001.*
[2] *In millions of U.S. dollars.*

Credit unions supervised by the Bank Superintendency are authorized to perform transactions with members—co-owners of the credit union who own share certificates—and also with clients—persons who do business with the credit union but who have not become members. While most services were still provided for members who owned shares in the institution, the non-member client share was growing in the seven institutions that were authorized to serve the open market. Table 8.3 shows the breakdown of members versus non-member clients in those institutions.

Table 8.3 Credit Union Members and Clients in 14 Credit Unions[1]

Credit Unions Supervised by	Number of Members	Number of Clients	Total
Bank Superintendency	256,637	93,027	349,664
DINACOOP	106,750	1,427	108,177
Total	363,387	94,454	457,841
Percent	79.4%	20.7%	100.0%

[1] *As of October 2001.*

Savings Mobilization

The 14 credit unions used an array of demand and fixed-term products to mobilize savings. The characteristics of the products and the strategies employed to promote them were similar for all 14 credit unions.

Demand Deposits

Demand deposits represented the most important financial product that the credit unions offered. The main feature of demand deposit accounts is that they do not have predetermined withdrawal dates. Most demand accounts allow unlimited withdrawals.

Opening of accounts. To open a savings account, the credit unions required a person to present an original personal identification card of which a copy was made, one passport-sized photograph, and a minimum deposit. The minimum deposit varied among the credit unions, depending mostly on geographic region. In the 14 credit unions in this study, the minimum deposit ranged from $5 to $42. According to the internal policies of each institution, this initial deposit was distributed among the demand deposit account, the share certificate account, and, in limited cases, an administrative charge was applied for opening the account.

Products offered by credit unions. The credit unions generally offered traditional demand savings products. Only a few had diversified or modified these products in order to encourage savings. The demand deposit products included primarily passbook savings and account savings.

Standard Passbook Accounts. These accounts are opened for all members when they join a credit union. Some institutions differentiate this product according to their target audiences. Examples of specialized passbook accounts include:

- **Special Passbook Savings:** Similar to the standard passbook account, but with a higher minimum balance requirement and a higher interest rate. In some institutions, the rate is based on average balance; in other cases it is based on the amount in an account at specific times.
- **Youth Savings:** Provides incentives for children and youth to save. A legal guardian of the minor has to sign for the account. These accounts require lower minimum balances and pay lower interest rates than the standard passbook account.
- **Business Savings:** Intended to attract savings from trade unions, associations, institutions, and organizations. Higher minimum opening deposits and balances are required for

these accounts, although they offer higher interest rates than the standard passbook account.

Account Savings. This type of account provides members access to their savings with a mechanism similar to checking accounts. Members use a booklet of withdrawal slips for their accounts (similar to checks). The withdrawal slips are acceptable as payments at businesses where the credit union has established contracts. The payee of the "check" would go to the credit union to collect payment, after verification of sufficient balance and authorized signatures. Because it offers the convenience of a checking account, this type of demand savings has been an attractive product to members. Although not yet widespread (it was offered in only two of the 14 credit unions), account savings has been effective for mobilizing deposits and increasing membership.

Volume of demand deposits. Table 8.4 shows the demand deposit balances in the credit unions. Of the 14 credit unions studied, the seven supervised by the Bank Superintendency had raised higher levels of savings than those supervised by DINACOOP.

Table 8.4 Demand Deposits in 14 Credit Unions[1]

Credit Unions Supervised by	Demand Deposits[2]	%
Bank Superintendency	37.3	69.6
DINACOOP	16.3	30.4
Total	53.7	100.0

[1] *As of October 2001.*
[2] *In millions of U.S. dollars.*

It is important to note that 50 percent of the demand savings received by the group of credit unions supervised by the Bank Superintendency was concentrated in two institutions. One of these credit unions focused on increasing the number of clients: by increasing the number of members, and more importantly, the number of non-member clients. The latter had the option to open demand deposit accounts without having to credit a share account, as would be the case with members who joined the credit union. The other credit union made brand and product marketing the priority in its strategy for increasing the volume of deposits. Both strategies have been effective for mobilizing increased savings.

Among the seven credit unions supervised by DINACOOP, two stood out as having raised 70 percent of the demand deposits of this group. In one credit union, the savings mobilization strategy was based on interest rate management; this institution offered the highest interest rates of the entire group of 14 credit unions. In the second credit union, success was based on increased points of sale. After only five years of operation, this institution had 11 offices to better serve populations located in rural areas. Both strategies have been effective for mobilizing increased savings.

Interest rates and amounts. A wide range of interest rates were paid on demand deposits. In the credit unions supervised by the Bank Superintendency, interest rates ranged from 2.75 percent to 6 percent. The credit unions overseen by DINACOOP offered higher interest rates, between 4 and 10 percent. Table 8.5 shows the interest rates on demand deposits in the 14 credit unions.

In eight of the 14 credit unions, the interest rate on demand savings was paid independently of the amount deposited. The remaining six credit unions paid interest rates based on the amount in the account or the average balance in the account.

Table 8.5 Interest Rates on Demand Deposits in 14 Credit Unions[1]

Credit Unions Supervised by	Minimum %	Maximum %
Bank Superintendency	2.75	6.00
DINACOOP	4.00	10.00

[1] *As of October 2001.*

All the credit unions calculated interest paid on demand savings accounts on a daily basis; however, the crediting of accounts differed from one credit union to the next. Some credit unions credited accounts daily, while in other institutions accounts were credited monthly, quarterly, or semi-annually.

Interest rate reviews. Generally, interest rate reviews were based on fluctuations in demand and changes in the market. There were no stated terms for interest rate reviews in most of the credit unions. Two credit unions had finance committees that performed regular analyses and follow-ups on rate reviews; the proposals for revision of savings rates were presented to managers and then approved by the boards of directors. Half of the credit unions indicated that a review was performed quarterly, mainly in response to market changes.

Fixed-term Savings

Fixed-term deposit accounts, such as certificates of deposit and programmed savings, were also important products offered by the credit unions in the study. Certificates of deposit were made in one deposit with interest paid upon maturity. Programmed savings included a variety of plans to encourage systematic savings during a determined period for a specific purpose. Interest on programmed savings was paid out at maturity.

Certificates of deposit. The credit union and the member or client signed a contract at the time of deposit to define the amount, term, and rate of interest to be paid on the certificate. This product offered interest rates higher than those paid on demand deposits. Interest rates varied according to the amount of deposit, term, and transaction history of the member (including his or her history of managing credit obligations). The interest rates on certificates of deposit in the credit unions supervised by the Bank Superintendency ranged from 4 percent to 11 percent. In the credit unions supervised by DINACOOP, the interest rates paid on certificates of deposit ranged from 4.5 percent to 12 percent. Table 8.6 shows the interest rates paid on certificates of deposit in the credit unions.

Table 8.6 Interest Rates on Fixed-term Certificates of Deposit in 14 Credit Unions[1]

Credit Unions Supervised by	Minimum %	Maximum %
Bank Superintendency	4.0	11.0
DINACOOP	4.5	12.0

[1] *As of October 2001.*

In most cases, interest rates on certificates of deposit were subject to negotiation, depending upon the amount deposited. The credit union manager was authorized to increase the rate by an additional 0.25 percent to 1 percent, depending on the amount, maturity date, and type of client.

Fixed-term certificates of deposit accounted for a much greater percentage of total deposits in the credit unions overseen by DINACOOP. Because of the instability of the Ecuadorian economy, the credit unions supervised by the Bank Superintendency considered these products to be higher risk and, consequently, made little effort to market them. Nevertheless, for this group of credit unions, fixed-term savings have been popular for attracting non-member clients. As Table 8.7 shows, fixed-term deposits accounted for 26.2 percent of the total volume of demand and fixed-term savings in the 14 credit unions.

Table 8.7 Volume of Total Savings in 14 Credit Unions[1]

Credit Unions Supervised by	Demand Deposits[2]	Fixed-term Deposits[2]	Total Deposits
Bank Superintendency	37.3	6.0	43.3
DINACOOP	16.3	13.1	29.4
Total	53.7	19.1	72.7
Percent	73.8%	26.2%	100.0%

[1] *As of October 2001.*
[2] *In millions of U.S. dollars.*

Programmed savings. Also known as *"Ahorro Plan"* in most of the institutions, programmed savings required members to deposit fixed amounts on a set basis, according to the different plans. The 14 credit unions provided various options with respect to the amounts of deposit, interest rates, and terms. Members could select the plans that best accommodated their personal saving needs.

Two programmed products were particularly well received in the Ecuadorian market.

- **Educational Savings:** These savings were accumulated through periodic deposits and applied to the educational expenses of the children of members. The interest rates and conditions varied from one credit union to another.
- **Retirement Savings:** These deposits were made over several years for capital accumulation that would enable the savers to have monthly stipends when they retired. The value of the deposit, term, and rate paid were established in advance through a contract between the member and the credit union.

The interest rates, terms, and deposit amounts for programmed savings accounts were set in advance. These features varied according to the policies of each credit union and the core characteristics of each product. The period of deposit was usually greater than one year and interest rates were higher than those offered on demand deposits.

In general, programmed savings products did not represent a significant volume of savings for any of the 14 credit unions. In many cases, members were unaccustomed to programmed savings, or they lacked the means to comply with the objectives or terms throughout the life of the account. Even so, programmed savings have enabled the credit unions to offer a broader range of products and services to existing and potential members and clients.

Strategies for Savings Mobilization

Managers in the credit unions generally did not have planned-out strategies for savings mobilization over the medium or long term. However, many did conduct activities with the specific objective of mobilizing savings. Most of the institutions focused on immediate differentiation of products to create a clear brand and product identification in the local market (town, district, or province). The key elements in the differentiation of demand deposit services included:

- **Institutional image:** The credit unions publicized the sound management practices of directors and managers that were from the local market; flexibility of management in problem solving; financial results attained (profitability, volume, low delinquency rate); and personalized service.
- **Interest rates:** Most of the credit unions offered rates competitive in their local markets. Only two of the 14 credit unions had interest rates that exceeded the local rates offered on savings. Those two credit unions used their higher interest rates to attract new members and mobilize new deposits. Interest rate reviews were conducted regularly in all the institutions.
- **Rapid service:** All of the credit unions tried to reduce the time a member spent on transactions. They did this by simplifying procedures and opening more teller windows.
- **Hours of service:** Most of the credit unions provided extended hours of attention to the public, generally from 8:30 a.m. to 6:00 p.m. without interruption. Many credit unions opened teller windows on weekends and holidays.

- **Publicity and advertising:** The credit unions advertised on a large scale through the radio and with flyers and brochures, and on a smaller scale through the print media and television. Savings services were promoted and linked to other services and benefits offered by the institutions. Some credit unions emphasized loan products and loan transaction speed as benefits to encourage savings. They sponsored local social, cultural, and sporting events as another form of publicity. Some of the institutions used door-to-door campaigns to attract larger deposits.
- **Promotions:** Raffles were commonly conducted to raise deposits. According to several managers, raffles were the most effective way to mobilize new savings. The credit unions also gave away promotional gifts to attract savers, such as bags, shirts, hats, pens, key chains, and school supplies.
- **Points of sale:** The establishment of new points of sale within the credit union's service area promoted growth by attracting new members and raising savings from new markets.

All of these strategies were employed by the credit unions in various forms and at different times in their savings mobilization efforts. All of the credit unions increased their total deposits as a result of their targeted activities.

Survey of Members

To find out about member demographics, the study conducted by DGRV in November 2001 included a survey of more than 500 members of the 14 credit unions. The individual surveys were conducted through personal interviews. The survey sample was made up of members who came to the credit unions during the research period to make some type of transaction. Both savers and borrowers were randomly selected for the interviews.

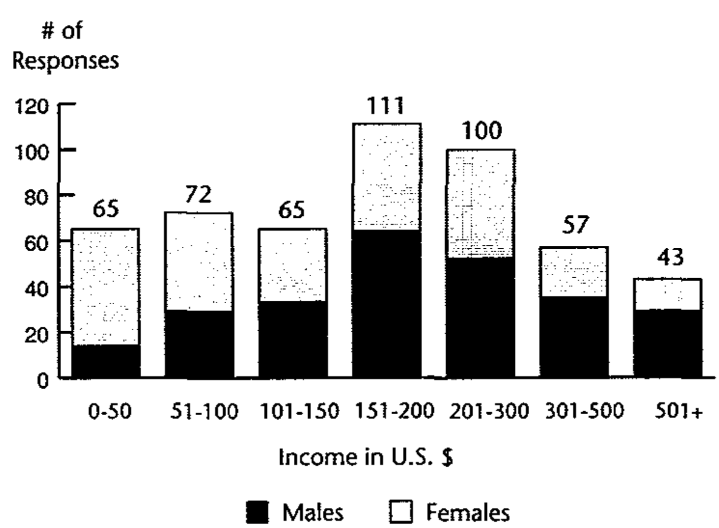
Income

The survey found that more than one-third of the members (39 percent) had monthly incomes of less than $150; 30 percent of males and 49 percent of females earned less than $150 per month. Forty-five percent of men and 37 percent of women earned between $151 and $300 monthly. Twenty-five percent of the men and 14 percent of women earned more than $300 per month. These results indicated an average monthly income of $243 for men and $179 for women. Table 8.8 shows the distribution of members according to gender and monthly income. Figure 8.1 illustrates the distribution of members according to gender and monthly income with females and males consolidated.

Table 8.8 Distribution of Members According to Monthly Income

	Male		Female		Total	
Savings in U.S. $	Number of Responses	%	Number of Responses	%	Number of Responses	%
0 – 50	14	5.5	51	19.8	65	12.7
51 – 100	29	11.3	43	16.7	72	14.0
101 – 150	33	12.9	32	12.5	65	12.7
151 – 200	64	25.0	47	18.3	111	21.6
201 – 300	52	20.3	48	18.7	100	19.5
301 – 500	35	13.7	22	8.6	57	11.1
501+	29	11.3	14	5.4	43	8.4
Total	256	100.0	257	100.0	513	100.0

Figure 8.1 Distribution of Members According to Monthly Income



Savings

More than half of the female members (56 percent) saved up to $20 per month in their credit unions. Twenty-one percent saved $21 to $50 per month; 16 percent saved between $51 and $100; and 6 percent saved more than $100 monthly. Forty-two percent of male members saved up to $20 monthly; 26 percent saved $21 to $50; 17 percent saved $51 to $100; and 15 percent saved more than $100 per month. Table 8.9 shows the distribution of members according to gender and monthly deposits.

Table 8.9 Distribution of Members According to Monthly Deposits

	Male		Female		Total	
Savings in U.S.$	Number of Responses	%	Number of Responses	%	Number of Responses	%
0 – 10	67	26.2	79	30.7	146	28.5
11 – 20	41	16.0	65	25.3	106	20.7
21 – 30	30	11.7	27	10.5	57	11.1
31 – 50	37	14.5	28	10.9	65	12.7
51 – 70	16	6.3	18	7.0	34	6.6
71 – 100	27	10.5	24	9.3	51	9.9
101+	38	14.8	16	6.2	54	10.5
Total	**256**	**100.0**	**257**	**99.9**	**513**	**100.0**

Figure 8.2 Distribution of Members According to Monthly Deposits

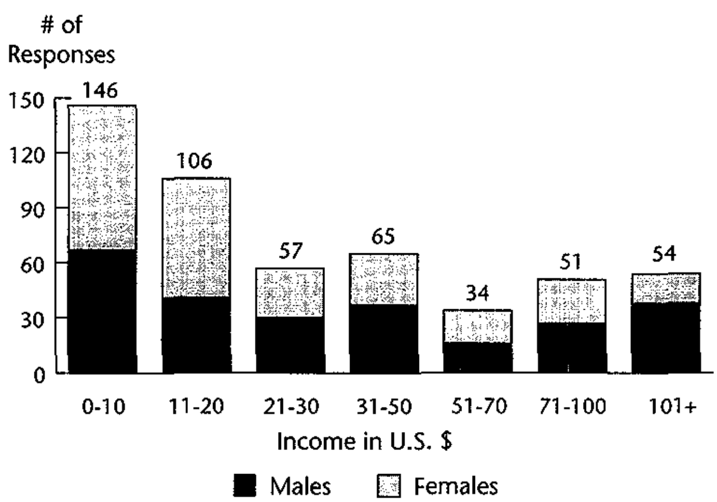


Figure 8.2 illustrates the distribution of members according to monthly deposits, with females and males consolidated, to show the breakdown of savings per month by deposit size.

Reasons for Saving

For both men and women, the principal reasons for saving with their credit unions were: to obtain loans (26 percent), for emergencies (16 percent), for security (16 percent), for health expenses (11 percent), for housing (9 percent), for future commitments (8 percent), and for education (7 percent). Among male members, the three main reasons were: to obtain loans (28 percent), for security (18 percent), and for emergencies (13 percent). In the case of female members, the three primary reasons were: to obtain loans (23 percent), for emergencies (19 percent), and for security (14 percent). Table 8.10 shows the distribution of members according to principal reasons for saving. Figure 8.3 illustrates the principal reasons that males and females saved in credit unions to show the trends by gender.

Deposit Terms

As Table 8.11 shows, the majority of members (61.6 percent) deposited savings for terms of less than 30 days. Figure 8.4 highlights the trends by gender.

Other Types of Savings

When asked about the other types of savings instruments they used, 38 percent of members said that they purchased assets, 31 percent safeguarded money in their homes, and 24 percent said they had no other types of savings. Six percent of members indicated they made loans to others as a form of savings.

It is apparent that there is significant potential to increase savings deposits by mobilizing the funds that members keep at home. At the same time, given the general crisis of the Ecuadorian financial system during recent years, there is a strong preference for the purchase of goods (assets) as an alternative form of savings.

Table 8.12 shows the distribution of members according to gender and other types of savings. Figure 8.5 illustrates the distribution of male and female members according to other types of savings, to show the trends by gender.

Table 8.10 Distribution of Members According to Reasons for Saving

Reasons for Savings	Male: Number of Responses	Male: %	Female: Number of Responses	Female: %	Total: Number of Responses	Total: %
Obtain loans	123	28.4	95	22.8	218	25.7
Security	79	18.2	58	13.9	137	16.1
Emergencies	58	13.4	78	18.8	136	16.0
Health	40	9.2	50	12.0	90	10.6
Housing	41	9.5	38	9.1	79	9.3
Future commitments	39	9.0	29	7.0	68	8.0
Education	28	6.5	33	7.9	61	7.2
Earn interest	18	4.2	29	7.0	47	5.5
Purchase appliances	7	1.6	6	1.4	13	1.5
Total	**433**	**100.0**	**416**	**99.9**	**849**	**99.9**

Figure 8.3 Distribution of Members According to Reasons for Saving

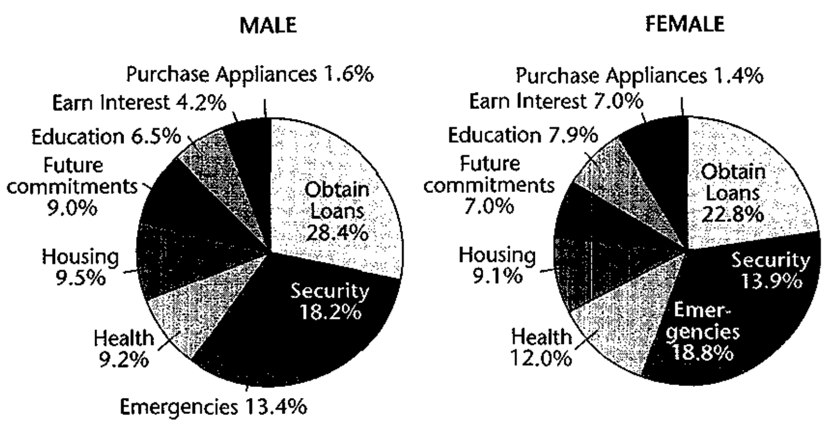


Table 8.11 Distribution of Members According to Deposit Term

	Male		Female		Total	
Term in Days	Number of Responses	%	Number of Responses	%	Number of Responses	%
Less than 30	152	59.3	164	63.8	316	61.6
30 – 60	77	30.1	65	25.3	142	27.7
61 – 90	13	5.1	17	6.6	30	5.8
91 – 180	4	1.6	3	1.2	7	1.4
181 – 360	2	0.8	3	1.2	5	1.0
361 +	8	3.1	5	1.9	13	2.5
Total	**256**	**100.0**	**257**	**100.0**	**513**	**100.0**

Figure 8.4 Distribution of Members According to Deposit Term

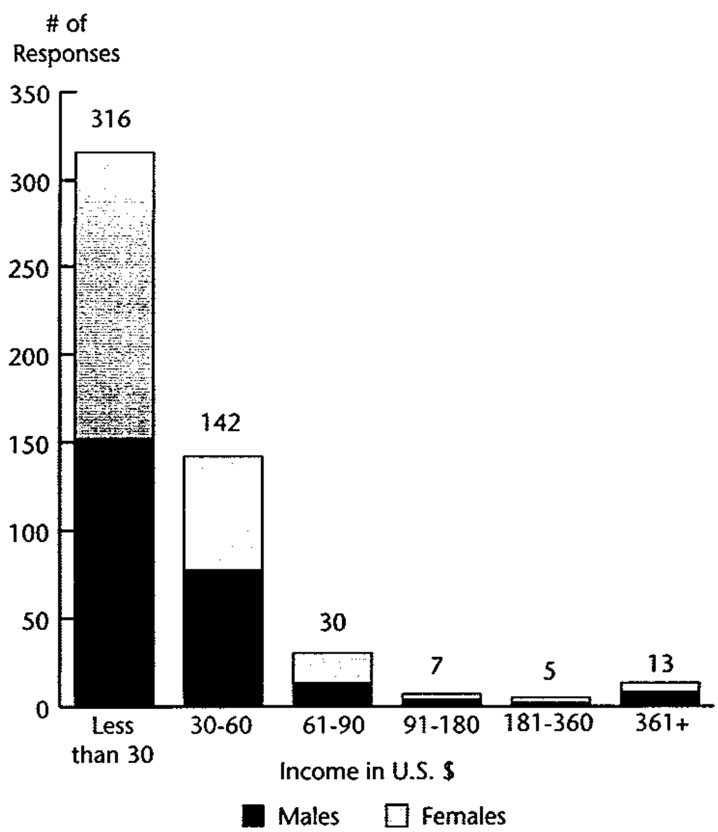
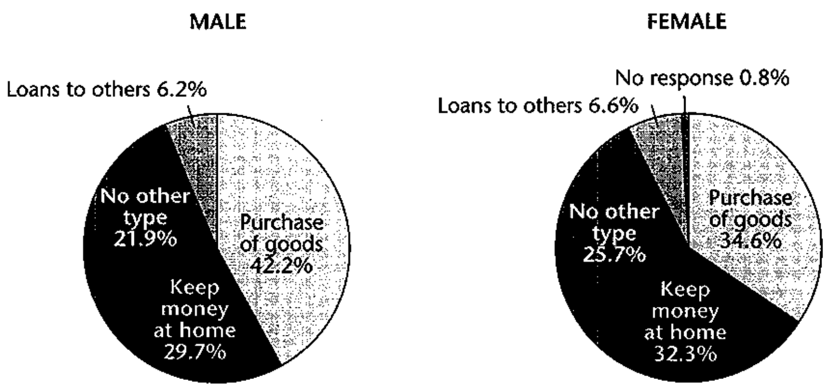


Table 8.12 Distribution of Members According to Alternative Savings Mechanisms

Type	Male: Number of Responses	Male: %	Female: Number of Responses	Female: %	Total: Number of Responses	Total: %
Purchase of goods	108	42.2	89	34.6	197	38.4
Keep money at home	76	29.7	83	32.3	159	31.0
No other type	56	21.9	66	25.7	122	23.8
Loan to others	16	6.2	17	6.6	33	6.4
No response			2	0.8	2	0.4
Total	**256**	**100.0**	**257**	**100.0**	**513**	**100.0**

Figure 8.5 Distribution of Members According to Alternative Savings Mechanisms



Profile of Credit Union Members

In addition to gathering data on income, savings amounts, reasons for saving, deposit terms, and types of savings held, the DGRV member survey recorded general statistics on members. It also probed member preferences and perspectives. Based on the data collected, the following member profile was created for the 14 credit unions:

- Adults from 30 to 49 years old made up the largest group of members; adults younger than 30 years old constituted the second largest group.
- Most members had monthly incomes of less than $150; in second place were monthly incomes of $151 to $300.
- Most members deposited average monthly savings of up to $20. The second largest group deposited average monthly savings of $21 to $50.
- Members saved in order to obtain loans, for emergencies, for health expenses, and for housing.
- They normally deposited their savings for less than 30 days (demand deposits). If they made fixed-term deposits, the majority did so for less than 60 days.
- Members sought quick and timely loans, high-quality service, and a positive institutional image of their credit unions.
- They selected a credit union because of security and trust, in order to obtain loans, to receive good service, and through referrals from other members
- They viewed their credit unions as places where they could go for credit and savings products. Other products, services, and benefits were supplementary.
- More than one-half of the members conducted business solely with their credit union. The rest also did business with banks (for checking accounts) and a few with more than one credit union. This diversification reflected a search for greater security.
- Even when they had access to financial services, some members preferred to purchase assets or safeguard money in their homes as alternative forms of savings.

Conclusion

Credit unions in Ecuador are mobilizing savings with success. Based on the data collected in this study of the 14 credit unions, we know that the credit unions supervised by the Bank Superintendency are larger and have mobilized greater levels of savings than those supervised by DINACOOP. All the credit unions offered demand and fixed-term savings products. Demand savings made up a much larger share of total savings than fixed-term savings. Interest rates on both types of products tended to be higher in the institutions supervised by DINACOOP.

The savings mobilization strategies employed by the 14 credit unions all drew on certain fundamental elements. Although the timing or details may have differed from one institution to another, they generally had the following objectives and activities:

- Financial services and benefits of savings and credit for members;
- Affordable interest rates for members;
- High-quality client service;
- Personalized visits and new points of service;
- Positive institutional image;
- Trustworthy managers and directors;
- Longevity of service or presence in the market;
- Informative and promotional campaigns;
- Management appearances in mass communication;
- Contributions to the development of the local market; and
- Greater participation in the formal financial market.

The institutional image, quality of member service, liquidity, directors and officers living in the area, and the stability of management for various years were considered fundamental elements for the establishment and promotion of security and soundness in the credit unions.

The survey of more than 500 members created a profile of members in the 14 credit unions, particularly in relation to their income and social condition. The survey found that there remained a surplus of funds that were saved in alternative mechanisms. The implementation of systematic programs and marketing to encourage a culture of savings in credit unions would serve to channel these resources toward the credit unions.

·Finally, the trust factor, the image of the institution, and the quality of service were the principal platforms for savings mobilization in the credit unions in Ecuador.

References

Paredes, Oswaldo Cabezas, Julio Cruz, and Hector Cuásquer. 2001. *Estudio de casos sobre movilización de recursos en cooperativas de ahorro y crédito del Ecuador.* Quito, Ecuador: German Confederation of Cooperatives.

World Council of Credit Unions, Inc. 2001. *National Survey of Credit Unions.* Quito, Ecuador: World Council of Credit Unions, Inc.

TOOLKIT

TOOL 1 Management Evaluation

Jesus R. Chavez

Management quality is the most forward-looking indicator of condition. It is a key determinant of whether an institution can diagnose and respond to financial stress. Management evaluation should include a review of salaried managers, officers, committees, and members of the board of directors—grouped here as *officials*. The assessment should evaluate their ability to manage and operate the savings institution safely, adhering to the institution's core values.

The management review assists in documenting specific strengths and weaknesses in management practices and emphasizes accountability for setting goals, measuring results, defining policies and procedures, and evaluating employee performance. As institutions become larger, add new staff, and implement new programs, the need for professional management increases. Material weaknesses in management should be of major concern and actions should be taken immediately to address them.

Management is responsible for current operations and future planning. A management review should determine that:

- Officials fully understand their duties and responsibilities;
- Officials are carrying out their responsibilities appropriately and in compliance with laws and regulations;
- Officials have developed adequate objectives and policies for all financial and operational areas;
- Officials are planning, directing, and controlling the institution, evidenced by the achievements or positive trends on the goals and objectives established;
- Conflicts of interest or self-dealing practices do not exist;

- Service to clients as reflected in market penetration and rate structures is appropriate;
- Officials keep abreast of new developments in the microfinance industry and adapt to change; and
- Management decisions are sound.

The following checklists are intended to assist institutions and supervisors to evaluate the management of a savings institution. The first checklist can be utilized to assess the management structure of the institution. The second, "Red Flag Checklist," can be used to evaluate the effectiveness of management; by its very design, it enables evaluators to identify trouble spots immediately.

MANAGEMENT STRUCTURE CHECKLIST

Financial Management	✔
1. Have short- and long-term business plans, which set out goals and objectives, been defined and documented in writing?	
2. Is an income/expense budget prepared that is compatible with the size and complexity of the institution?	
3. Are variances between budgeted and actual income and expenses periodically reviewed and explained in writing?	
4. Does the budget coincide with the goals and objectives of the institution?	
5. Are capital growth/maintenance plans consistent with the institution's capital needs, risk exposure, and net income projections?	
6. Are progress reports on financial and operational goals analyzed periodically?	
7. Are cost/benefit relationships of services analyzed periodically?	
8. Is there an asset-liability management policy in place to address liquidity and profitability needs?	
9. Has management determined an acceptable method for monitoring the balance sheet's interest rate risk exposure in relation to profitability?	
10. Are adequate procedures in place for monitoring the current and future liquidity needs of the institution?	
11. Are material risks adequately insured?	

MANAGEMENT STRUCTURE CHECKLIST continued

Personnel Management

	✔
1. Are accurate position descriptions in place for all employees?	
2. Are all employees, including top management, provided a written evaluation of their performance at least annually?	
3. Do management contracts provide for the following:	
a. Measurable performance indicators?	
b. Conditions for discontinuance of contracts?	
c. Compensation increases which do not create unaffordable contingent liabilities?	
4. Does management have an adequate succession plan in place?	
5. Are all officials of the institution meeting the duties of their positions?	
6. a. If the institution issues loans to its officials or senior employees, are procedures in place to monitor payment on these loans?	
b. Does the internal auditor review these accounts?	

Operational Management

1. Are all operational procedures well defined and well documented?	
2. Are internal controls reviewed periodically?	
3. Are the books and records of the institution current and in balance, according to accepted practices?	

MANAGEMENT STRUCTURE CHECKLIST continued

Board of Directors	✔
1. Are board and committee policies well defined and well documented for all relevant areas of operation?	
2. Are written policies reviewed by the board regularly and updated or amended as necessary?	
3. Do the board minutes indicate that monthly meetings are held?	
4. Are charter and bylaw amendments approved by the appropriate regulatory agency?	
5. Does the board receive detailed financial information at least monthly?	
6. Has the board assured itself that all officials, employees, and their immediate families are not involved in any dealings with the institution that could be construed as insider dealings or preferential treatment?	
a. Is the board involved in the decision making process?	
b. Is this involvement documented in the board minutes?	
Other	
1. Does management strive to protect the core values, capabilities, and mission of the institution?	
2. Does management keep informed of new developments in the microfinance industry and adjust operations accordingly?	
3. Does management maintain a records preservation program?	
4. Does management have a written security program?	
5. Are external examination reports reviewed and formally acted upon with appropriate corrective action?	
6. Are supervisory committee and/or CPA audit reports reviewed and formally acted upon with appropriate corrective action?	
7. a. Are all contingent liabilities, such as accrued employee leave and pensions, salary continuances, and pending lawsuits, recognized by the institution?	
b. If yes, has the board evaluated the impact that the contingent liability could have on the financial condition of the institution?	
8. Have all outstanding bond claims been properly closed?	

RED FLAG CHECKLIST

Accounting – Reconciliation

	✔
1. Ongoing record keeping problems	
2. Cash and bank reconciliations not complete, in arrears, or with (fluctuating) out of balance amounts	
3. Excessive teller overages or shortages, either in number or amount	
4. IOU's in teller or vault cash	
5. Numerous erasures, corrections, whiteouts, or lineouts	
6. Numerous voided or third party checks	
7. Numerous stale-dated outstanding checks	
8. Numerous stale-dated reconciling items	
9. Lump sum postings not conducive to good audit trail	
10. Checks or transaction receipts missing or out of sequence	
11. Timeliness of deposits not in accordance with bylaw requirements	
12. Bank account activity and/or bank account balances (or share draft clearings/total share draft balances) exceed realistic limits	
13. Excessive number of depository accounts providing potential for kiting	
14. Excessive cash/assets ratio (indicates poor cash management or possibly fraud)	

RED FLAG CHECKLIST continued

Management	✔
1. Regular vacations not taken, always working late hours	
2. Nepotism	
3. Limited personnel not conducive to segregation of duties	
4. Lack of adequate segregation of duties where the institution is adequately staffed	
5. Failure to provide, or delays in providing, standard reports, records, or documents	
6. Records maintained at home, or not in formal record storage	
7. Management or staff provide copies of documents, rather than the originals	
8. Lack of, unacceptable, or non-independent audit or verification	
9. Inadequate internal controls and/or information system controls	
10. No internal review of override/non-financial reports	
11. Bank account frequently overdrawn	
12. High volume of excessive transactions	
13. Use of borrowed funds in spite of large cash balances	
14. Lack of a fraud policy	

RED FLAG CHECKLIST continued

Cash	✔
1. Observe staff count all cash in the presence of a manager and determine that the count balances with the general ledger	
2. Spot-check several months of bank and corporate account reconciliations	
3. Verify all outstanding items on the bank\corporate reconciliations, especially deposits in transit	
4. Determine that adjusting entries are cleared in a timely manner	
5. Review several months' bank statements for reasonableness of total deposits and withdrawals	
6. Perform gross receipts and disbursements testing for two months	
7. Determine that deposits are made in a timely manner in accordance with applicable bylaws or policies	
8. Randomly review cancelled and voided checks for unusual payees	
9. Determine whether dual control exists over mail receipts, night depositories, and vault cash	
10. Verify that proper controls are in place over wire transfers (If applicable)	
Internal Controls	
1. Review the following reports on a random basis:	
a. Supervisory override reports	
b. File maintenance reports	
c. Dormant account activity reports	
d. Overdraft reports	
2. Determine if computer access codes are in place	
3. Complete internal control checklist	

RED FLAG CHECKLIST continued

Lending	✔
1. Review loan reports as follows:	
a. Paid-ahead loan report	
b. Non-amortizing/single payment loan report	
c. Loan concentration report	
d. Loans with no activity report	
e. First payment default report	
f. Loans with large payments reports	
g. Zero interest loan reports	
2. Trace written off loans to approval in the board minutes	
3. Determine proper loan/credit committee controls are in place	
4. Scan/review the savings and loan trial balance for any unusual balances, interest rates, payment amounts, loan dates, or account numbers	

TOOL 2 Calculating Interest on Savings

Jesus R. Chavez

Savers receive payment in the form of interest earned on deposits in return for allowing the savings institution use of their funds. While many microfinance institutions (MFIs) are becoming computerized, and have automatic calculations of interest or dividends on savings, there are still many institutions that are not automated; they calculate interest and maintain their general and subsidiary ledgers manually. This tool is intended for savings institutions that operate with manual systems. The instructions that follow can also be used to explain to clients how interest is earned on their passbook savings and term deposits.

While this tool focuses on the calculation of interest rates once the rates have been set, it is important to note here that officials should exercise caution when establishing the interest rates to be paid on savings. If an institution promises to pay an interest rate that it cannot meet, clients will lose confidence in the institution. When the institution loses credibility, clients are likely to withdraw their savings. Mass savings withdrawals could cause a crisis in the institution.

Accrued Interest Payable

Most institutions in developing countries use cash accounting. In other words, they recognize income when the cash is actually received and expenses when they are actually paid. This often means that they are not recognizing the interest owed to clients on their savings (or dividends owed to members in credit unions). For many credit unions, this worked fine in the past, since they only paid dividends on shares at the end of the year and offered the most basic of savings and loan products.

Today's savings institutions need to be conservative in their operations: they should not accrue the interest on loans, but they should accrue (recognize) the interest due to clients on savings. Savers expect returns on their deposits and savings institutions today offer a variety of savings products, which are rate sensitive (meaning that the funds will leave the institution if it does not pay competitive rates). As a result, the accrued interest payable is becoming a significant liability. Institutions need to recognize this liability by accruing the interest due to clients, particularly if the interest is a contractual obligation of the institution. In addition, credit unions should estimate and accrue the anticipated dividend that will be paid on member shares at the end of the operating year.

The interest on savings (and dividends on shares in credit unions) should be shown as expenses in the Statement of Income. Interest (and dividends) should be recorded as current charges in the fiscal period to which they apply.

Common mistakes to avoid. Savings institutions in some countries do not recognize the liability until the term deposits mature or are withdrawn; as a result, an institution could be insolvent and not even know it. Some credit unions do not recognize the dividends in the proper fiscal period; because the dividend was declared after the end of the year, they place the dividends in the following year. This is incorrect. The expense needs to be recognized in the operating year in which it was incurred.

Accounting Entries for the Interest on Savings

Interest must be shown as an expense in the Statement of Income for the period to which it applies. Interest should be recorded as of the close of the applicable interest period by a debit to the *Interest Expense* account and a credit to the *Interest Payable* account.

When the interest liability credited to the *Interest Payable* account is liquidated, the account should be debited and the offsetting credit should be to the *Cash* or *Savings* accounts. The *Interest Payable* account should be used only at the end of the period to reflect the actual or estimated amount of interest that is due and payable to clients.

Savings institutions that accrue interest expenses on a more frequent basis than the actual interest period should record the liability in the *Accrued Interest Payable* account. For example, an institution that declares and pays quarterly interest but accrues interest expenses monthly would record the liability in the *Accrued Interest Payable* account in between the actual interest periods (in cases where the interest is not credited to clients' accounts until the month following the end of the interest period). On financial statements for the months at the end of each interest period (quarterly: March, June, September, and December), the liability should be transferred from the *Accrued Interest Payable* account to the *Interest Payable* account.

Where the interest is credited to clients' savings accounts on the last day of the period, the entry should be a debit to *Accrued Interest Payable* account and a credit to *Savings*. The financial report for the end of the quarter should have no balance in the *Interest Payable* or *Accrued Interest Payable* accounts.

Entries in the Journal and Cash Record

All entries affecting these accounts should be recorded as *Miscellaneous* in the Journal and Cash Record.

Example Entries

The following entries are used to record the estimated interest liability for the months of July, August, and September when the institution is on a quarterly interest period and interests are credited to clients' savings accounts on the first day of the next interest period (assuming one type of savings).

a. The following entries would be made at the end of each month:

Dr.-Interest Expense	\$1,000	
Cr.-Accrued Interest Payable		\$1,000

The balance of the *Accrued Interest Payable* would be \$3,000 at the end of September.

b. When the interest is distributed to clients' accounts on September 30, and the actual amount of the interest is \$2,900:

Dr.-Accrued Interest Payable	\$3,000	
Cr.-Savings		\$2,900
Cr.-Interest Expense		\$100

c. If we use the same examples as (a) above, except that interests are credited to clients' accounts on the first day following the end of the interest period, entries for each month would be the same as (a) above:

Dr.-Interest Expense	$1,000	
Cr.-Accrued Interest Payable		$1,000

d. To record the interest payable as of September 30 for example (c) above:

Dr.-Accrued Interest Payable	$3,000	
Dr.-Interests Payable		$3,000

e. When Interest for (c) and (d) above is credited to clients' accounts on October 1, and the actual interest amounts to $2,900:

Dr.-Interest Payable	$3,000	
Cr.-Savings		$2,900
Cr.-Interest Expense		$100

Detail of Transactions
CREDITS

1. To record the amount of interest either declared or estimated during an accounting period;
2. With the excess of actual interest, if any, over the amount previously recorded.

DEBITS

1. To liquidate the amount of interest liability upon distribution to clients;
2. With the amount or difference, if any, between the accrued amount and the actual amount of interest payable.

Calculation of Interest on Savings

This section will provide instructions and examples for calculating interest on passbook savings and term deposits.

Interest Periods

The interest period is the span of time at the end of which savings in a client's account earn interest. Interest periods may vary; they may be daily, weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annual, or annual. Interest periods may differ for different types of savings products. In all cases, savings accounts must have established and published interest periods.

Interest Declaration Dates

In credit unions, the interest declaration date is the date that the board of directors declares an interest rate for the preceding period. For credit unions with longer interest periods (such as quarterly, semi-annual, or annual) the interest rate must be determined:

1. During the last month of the interest period; or
2. If the interest rate is determined prior to the end of the interest period, the rate is not declared but rather anticipated (projected), contingent upon income and earnings after required transfers to statutory reserves, during the first month following the close of the interest period.

The board of directors determines that there are sufficient earnings available after provisioning for loan losses and transfers to statutory reserves and ratifies the interest rate (most likely the anticipated rates). The day the interest rate is ratified is the interest declaration date.

Calculating Interest on Passbook Savings

There are two methods to calculate the interest on passbook savings:

1. The daily balance method; and
2. The average daily balance method.

Examples of each method are provided using account activity for one month, based on the *end-of-day balance* in the account. The interest calculation must be based on a point in time for determining the balance in the account, such as *beginning-of-day balance, end-of-day balance,* or *close-of-business-day balance.* Any one of the three may be used, but must be applied consistently.

EXAMPLE: Using the daily balance, based on end-of-day balance
The daily balance method is the application of a daily interest rate to the full amount of principal in the account each day. For the days the account is overdrawn, a zero balance is used to calculate the interest for those days.

The client makes numerous transactions throughout the month:

TRANSACTION	DATE	AMOUNT	CLIENT'S BALANCE
Balance	12/31/2001		$1,000
Deposit	01/01/2002	$200	$1,200
Withdrawal	01/02/2002	$100	$1,100
Withdrawal	01/10/2002	$400	$700
Deposit	01/15/2002	$200	$900
Withdrawal	01/16/2002	$1,000	-$100
Deposit	01/18/2002	$300	$200
Deposit	01/21/2002	$700	$900
Withdrawal	01/31/2002	$100	$800

We assume an interest rate of 5.0%, a daily rate based on 1/365, a monthly compounding period, and a monthly crediting period. The daily rate would be 0.00013698630 (0.05 x (1/365)).

The interest due to the client above, based on the transactions above for the month of January is:

The formula is: **Interest = Balance x Daily Rate x Number of Days**

DATES	NUMBER OF DAYS	CALCULATIONS	INTEREST AMOUNT
01/01/02	1	$1,200 x 0.00013698630	$0.164383562
01/02/02 to 01/09/02	8	$1,100 x 0.00013698630	$1.205479452
01/10/02 to 01/14/02	5	$700 x 0.00013698630	$0.479452055
01/15/02	1	$900 x 0.00013698630	$0.123287671
01/16/02 to 01/17/02	2	$0 x 0.00013698630	$0.000000000
01/18/02 to 01/20/02	3	$200 x 0.00013698630	$0.082191781
01/21/02 to 1/30/02	10	$900 x 0.00013698630	$1.232876712
01/31/00	1	$800 x 0.00013698630	$0.109589041
TOTAL	**31**		**$3.397260274**

Using the daily balance method, interest of $3.40 would be credited to the client's account for the month of January.

If the compounding period had been daily, there would have been 31 (the number of days in the compounding period) separate interest calculations performed. The first day's accrued, but uncredited, interest of $0.164383562 would have been included in the second day's balance to determine the second day's interest, and every day's interest thereafter.

EXAMPLE: Using the average daily balance, based on end-of-day balance

The average daily balance method is the application of a periodic interest rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the interest period.

We assume of interest rate of 5.0%, a daily rate based on 1/365, a monthly compounding period, and a monthly crediting period. The periodic interest rate would be 0.00424657534 (0.5 x (1/365) x 31). Interest would be calculated as follows:

The formula is: **Interest = Balance x Number of Days**

Dates	Balance	Number of Days	Client's Accumulated Balance
01/01/02	$1,200	1	$1,200
01/02/02 to 01/09/02	$1,100	8	$8,800
01/10/02 to 01/14/02	$700	5	$3,500
01/15/02	$900	1	$900
01/16/02 to 01/17/02	0	2	$0
01/18/02 to 01/20/02	$200	3	$600
01/21/02 to 1/30/02	$900	10	$9,000
01/31/02	$800	1	$800
TOTAL		31	$24,800

The accumulated *end-of-day* balance of $24,800 is divided by 31 (the total number of days in the interest period) to find the average daily balance of $800. The average daily balance should be rounded to five or more decimals, in this case $800.00000. In the case of overdrawn accounts, zero is used as the balance, since negative balances cannot be used in determining the average daily balance. The periodic interest rate multiplied by the average daily balance results in an interest amount of 0.004246575.

Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.50 times 1/365	Result: 0.000136986
Step 3	0.000136986 times 31	Result: 0.004246575
Step 4	0.004246575 times $800	Result: 3.397260274
Step 5	Rounded	Result: $3.40

Using the average daily balance method, interest of $3.40 would be credited to the client's account for the month of January. In these examples, the two different methods yielded the same amount of interest due to the client.

Term Deposits

For the purposes of this exercise, term deposits include certificates of deposit, club accounts, and programmed accounts, which have some or all of the following characteristics:

- Minimum amount to open the account;
- Interest rates are subject to existing market conditions;
- No withdrawal of funds during the term of the deposit, often requires a notice of withdrawal and penalties are imposed for early withdrawal;
- In the case of club and programmed accounts, regular additions to the account are required; and
- Terms are all in accordance with a written contract between the client and the institution.

The contract should contain the elements the institution considers necessary to protect itself and to make proper disclosures to the client. The contract should stipulate the frequency and the minimum amount of required payments to be deposited into the account. It also sets the interest rates and outlines any benefits of the account. The contract should answer the following questions:

1. What is the term or qualifying period? That is, how long must the client make regular payments to the account? For example, if the institution requires additions to the account for two years, two years is considered the qualifying period. It should be noted that a withdrawal of funds below the minimum amount requirement established may result in the imposition of a penalty.

2. Will the institution allow periodic payments in excess of the required amount to earn the premium interest rate and any other benefits of the account? If so, will the institution limit such excess amounts? Will additions to the account, after notice is provided, be permitted? Generally, additions to the account earn the premium interest rate if they are made pursuant to the contract.
3. What penalty, if any, will be imposed if the client fails to make the required periodic deposits? How many missed payments will constitute default?
4. Will notice of withdrawal require that a specific dollar amount be given? Will only a minimum amount have to be given or will it be a range of probable withdrawal amounts?
5. What is the minimum notice period and when must notice be provided?

The contract for term deposits should clearly set out all terms and conditions that affect the relationship between the savings institution and the client. A lack of specificity in the contract or incomplete coverage of the terms and conditions could result in problems for all parties.

Notice Upon Maturity

The institution should alert the client at least ten days prior to the maturity date of the account that the agreement is reaching maturity, and that if the client does not advise the savings institution on what to do with the proceeds, the proceeds will roll over into a new account with the current terms and conditions. Where certificates allow clients to add funds to their accounts, the additional funds do not extend the maturity of the certificate. Additions to the account are, however, usually subject to the same premature withdrawal penalties as the contracted amounts.

Interest Reductions and Penalties

Penalties are imposed for failure to comply with the terms or conditions of the contract. Generally, the penalties are on the interest earned on the account, subject to the institution's policies. A premature withdrawal of principal which reduces the balance below the required balance may cause the account to be cancelled, or liquidated into a passbook account. If the required minimum continues to be met, an interest rate penalty may be imposed only on the amount withdrawn.

A savings institution pays a higher interest rate on term deposits so that it can plan to use those funds for a determined period. The penalty should be sufficient to discourage clients from withdrawing funds in term deposits before the maturity date. Otherwise, the institution ends up paying a higher cost for the funds without being able to use them over longer periods.

Two Formulas for Calculating Compounding Interest on Term Deposits

Two simple formulas can be used to calculate compounding interest on term deposits (the two formulas should actually provide the same result if the institution has an automated system). In both cases, interest is paid monthly (or according to the set period), and interest the following month is paid on the new balance of the principal—including the interest earned for the previous month, and so on. The compounding continues until the maturity of the term deposit. The two formulas follow:

1. To calculate interest on term deposits compounding the interest:

$$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / \text{Compounding Period})^{(\text{Compounding Periods in Term})} - 1]$$

2. To calculate interest for term deposits when interest is paid at maturity:

$$\text{Interest} = \text{Principal} \times \text{Daily Interest Rate} \times \text{Days in Term}$$

Variables Used to Calculate Compounding Interest on Term Deposits

The formula is: $\textbf{Interest} = \textbf{Principal} \times [(1 + \textbf{Nominal Rate} / \textbf{Compounding Period})^{(\text{Compounding Periods in Term})} - 1]$

Nominal rate is determined by dividing the interest rate by 100, or the interest rate expressed as a decimal.

Compounding rate stands for compounding period. Use the following based on the compounding period:

- Daily – 360, 365, or 366 in a leap year if interest is earned on February 29 for daily interest payments

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 365)^{(365)} - 1]$$

- Weekly – 52 for weekly interest payments

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 52)^{(52)} - 1]$$

- Bi-weekly – 26 if interest is paid every two weeks

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 26)^{(26)} - 1]$$

- Semi-Monthly – 24 if interest is paid twice a month

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 24)^{(24)} - 1]$$

- Monthly – 12 if interest is paid every month

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 12)^{(12)} - 1]$$

- Quarterly – 4 if interest is paid every 3 months

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 4)^{(4)} - 1]$$

- Semi-annually – 2 if interest is paid twice a year

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 2)^{(2)} - 1]$$

- Annually – 1 for annual payments

  $$\text{Interest} = \text{Principal} \times [(1 + \text{Nominal Rate} / 1)^{(1)} - 1]$$

Compounding periods in term refers to the number of compounding periods in the term. If interest is paid daily, the term is expressed in the number of days. If interest is compounded other than daily, the term is expressed in the appropriate number (same as above, weekly = 52, bi-weekly = 26, etc.)

Principal is the amount of funds deposited by the saver.

Calculating Interest on Term Deposits When Interest is Paid at Maturity

The daily balance method is the application of a daily interest rate to the full amount of principal in the account each day.

EXAMPLE: Calculation of interest on a term deposit using the daily balance method, based on end-of-day balance

We assume an interest rate of 5.0%, a daily rate based on 1/365, a monthly compounding period, and a monthly crediting period. The daily rate would be 0.000013698630 (0.05 x (1/365)). The client has $1,000 in the account. The client makes one deposit and does not withdraw any funds during the six-month term of the contract (such as in a certificate of deposit). Interest would be calculated as follows:

The formula is: **Interest = Principal x Daily Interest Rate x Days in Term**

MONTH OF MARCH		
Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 31 days	Result: 0.00424658
Step 4	0.00424658 multiplied by $1,000	Result: $4.246575342
Step 5	Round to $4.2465753	Result: $4.2466
Step 6	$4.2466 plus $1,000	Result: $1,004.2466
MONTH OF APRIL		
Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 30 days	Result: 0.004109589
Step 4	0.004109589 multiplied by $1,004.12465	Result: $4.127040740
Step 5	Round $4.127040740	Result: $4.12704
Step 6	$4.12704 plus $1,004.24658	Result: $1,008.37362
MONTH OF MAY		
Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 31 days	Result: 0.004246575
Step 4	0.004246575 multiplied by $1,008.37362	Result: $4.282134551
Step 5	Round $4.282134551	Result: $4.28213
Step 6	$4.28213 plus $1,008.37362	Result: $1,012.65575

Month of June

Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 30 days	Result: 0.004109589
Step 4	0.004109589 multiplied by $1,012.65575	Result: $4.161598973
Step 5	Round $4.161598973	Result: $4.16160
Step 6	$4.16160 plus $1,012.65575	Result: $1,016.81735

Month of July

Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 31 days	Result: 0.004246575
Step 4	0.004246575 multiplied by $1,016.81735	Result: $4.317991486
Step 5	Round $4.317991486	Result: $4.31799
Step 6	$4.31799 plus $1,016.81735	Result: $1,021.13534

Month of August

Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 31 days	Result: 0.004246575
Step 4	0.004246575 multiplied by $1,021.13534	Result: $4.336328156
Step 5	Round $4.336328156	Result: $4.33633
Step 6	$4.33633 plus $1,021.13534	Result: $1,025.47167

A total of $25.47 in interest would be credited to the client's savings account.

Calculation of Simple Interest on Term Deposits

Two formulas can be used to calculate the interest on a term deposit where interest does not compound. The difference between the two formulas is that one considers the actual number of days in the term of the deposit and the other counts the months in the term of the deposit. There is a slight difference in the interest paid. The two formulas follow:

The formula is:
Interest = Principal x Monthly Interest Rate x Months in Term

Principal is the amount of funds deposited upon opening the account.

Monthly interest rate is the nominal rate divided by 100 (or the interest rate expressed as a decimal) and then divided by 12 (number of months in a year).

Months in term refers to the number of months in the period.

EXAMPLE: Client deposits $1,000 for six months with annual interest rate of 5.0%

Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 divided by 12 months	Result: 0.004166667
Step 3	0.004166667 multiplied by 6 months	Result: 0.025
Step 4	0.025 multiplied by $1,000	Result: 25.00

The payout, including principal and interest, at the end of six months is **$1,025.00**

The formula is: **Interest = Principal x Daily Interest Rate x Days in Term**

Principal is the amount of funds deposited upon opening of the account.

Daily interest rate is the nominal rate divided by 100 (or the interest rate expressed as a decimal) multiplied by the daily rate of 1/360, 1/365 or 1/366 during leap year if the account will earn interest on February 29.

Days in term refers to the number of days in the period.

EXAMPLE: Client deposits $1,000 for six months with annual interest rate of 5.0%

Step 1	5.0 divided by 100	Result: 0.05
Step 2	0.05 multiplied by 1/365	Result: 0.000136986
Step 3	0.000136986 multiplied by 184	Result: 0.025205479
Step 4	0.25205479 multiplied by $1,000	Result: 25.20547945
Step 5	Rounded	Result: $25.21

The payout, including principal and interest, at the end of six months is **$1,025.21**

These two examples show the difference between the two ways that simple interest can be calculated on term deposits. One way takes the number of days, while the other assumes that each of the six months has the same number of days. The difference between the two formulas yields a difference of **$0.21** in interest.

This tool provided readers with the basic principles for calculating interest on passbook savings and term deposits. Readers can run through the different examples using diverse scenarios (or scenarios from their own institutions) to achieve a better understanding of the varying results yielded by the different interest calculation methods.

TOOL 3 Evaluation of Internal Control in the Deposit Cycle

Mónica Valenzuela Bravo

The following form provides a tool for readers from institutions that are mobilizing savings, primarily passbook accounts and fixed-term deposits, to use in determining whether or not they apply sufficient internal controls to manage the deposits. In order to do this, it is necessary to:

- Identify internal control objectives;
- Verify which internal controls the institution currently employs; and
- Determine which controls should be implemented going forward.

The tool identifies the elements that make up an adequate internal control structure, establishes internal control objectives, and lays out control procedures.

This tool lists the control procedures that should be implemented in an institution that administers savings services through the use of automated systems. For those institutions that do not have automated systems, the manual procedures indicated in the *Applied Controls* section under questions 1, 2, 3, 5, 9, 11, 14, 15, 16 should be evaluated and implemented.

The highlighted rows indicate the absolute minimum controls required for mobilizing savings.

The evaluation form consists of 16 questions. Readers should follow these instructions when filling out the form:

a. Respond to each question using the answer options provided. Give only one answer per question.
b. Total the score obtained in each column according to the following scoring table:

Daily (D)	= 5 points
Weekly (W)	= 3 points
Monthly (M)	= 2 points
Yes	= 5 points
No	= 0 points

c. Calculate the total score by adding the scores obtained in each column.
d. Find the total score in the ranges indicated on the last page.
e. Analyze the results according to the guidance provided for the score you obtained.

Purpose of Control	Applied Controls	No (0)	Yes (5)	D (5)	W (3)	M (2)
1. AUTHORIZATION	**Deposit operations are authorized before being entered into the system for processing.** **Answer options: Yes – No**					
2. AUTHORIZATION	**There is adequate separation of duties with regard to the persons who perform the evaluation, review, and accounting of deposit operations. If two of these activities are the responsibility of one person, the answer should be "No."** **Answer options: Yes – No**					
3. AUTHORIZATION	To open an account, the institution requests a photocopy of a government-issued identification card of the client. All information is filled in on the account contract or certificate of deposit, including the client signature and staff confirmation of the signature. Answer options: **Yes – No**					
4. ALL OPERATIONS	Error reports are generated for transactions that are not processed; these are operations entered into the system that were not correctly updated or accepted for processing. Answer options: **Weekly – Daily – Monthly – No**					
5. ALL OPERATIONS	**The closing of the cash accounts is performed through the issuance of cash listings and balancing the cash count. The total amount received in deposits according to the cash count (actual) is compared with the total amount entered into the cash system or cash journal.** **Answer options: Weekly – Daily – No**					

PURPOSE OF CONTROL	APPLIED CONTROLS	NO (0)	YES (5)	D (5)	W (3)	M (2)
6. TOTALITY AND PRECISION OF UPDATES	Validations or reviews are performed to ensure that the term deposits paid out (paid in cash) are subtracted from the deposit system. Answer options: **Weekly – Daily – Monthly – No**					
7. TOTALITY AND PRECISION OF UPDATES	Validations or reviews are performed to ensure that the term deposits paid out (in cash) are correctly subtracted from the accounting system. Answer options: **Weekly – Daily – Monthly - No**					
8. TOTALITY AND PRECISION OF ACCUMULATED DATA	The calculation of interest and adjustments is performed automatically. Answer options: **Yes – No**					
9. TOTALITY AND PRECISION OF ACCUMULATED DATA	Interest and adjustments for savings accounts are credited to the client's account in accordance with the terms of the account contract and with current rules and regulations. Answer options: **Yes – No**					
10. TOTALITY AND PRECISION OF ACCUMULATED DATA	Trial balances, bank reconciliations, and account reconciliations are performed and reviewed for all deposit transactions. Answer options: **Weekly – Daily – Monthly – No**					
11. TOTALITY AND PRECISION OF ACCUMULATED DATA	Registers or tables are generated with the maturity dates of all outstanding fixed-term deposits. Telephone calls are made to clients to renew or cash out fixed-term deposits that are set to mature in the near future. Answer options: **Weekly – Daily – Monthly – No**					

Purpose of Control	Applied Controls	No (0)	Yes (5)	D (5)	W (3)	M (2)
12. INTEGRITY OF INFORMATION	Passwords are used to restrict access to automated deposit registers to specified users. Answer options: **Yes – No**					
13. INTEGRITY OF INFORMATION	The master files for deposits are reviewed in order to ensure that they are complete and up-to-date. Answer options: **Weekly – Daily – Monthly – No**					
14. CUSTODY	Certificates of deposit are held in a safe place, not accessible to the staff of the institution. Answer options: **Yes – No**					
15. CUSTODY	Account reconciliations are performed on all deposits and balances are verified. Answer options: **Weekly – Daily – Monthly – No**					
16. CUSTODY	Documents received for safekeeping are kept in a file cabinet, classified alphabetically, and are the responsibility of the Chief of Operations or the Treasurer. Answer options: **Yes – No**					

SCORING

		No	Yes	D	W	M
Total of each column						
Calculation of Total Score	*Maximum: 80 points* *Average: 40 points* *Minimum: 0 points*					

Analysis of Results

The score obtained represents a reference point for readers to use in determining the extent to which internal controls are applied in their own institutions. This form should enable readers to evaluate the importance and impact of the controls that are not applied. *In order to achieve an internal control system that is reasonable, although not fully sufficient, it is necessary to comply with at least the controls indicated in the highlighted sections.*

Score of 60 points or more

A score of 60 points or more means that the controls applied for the deposit cycle are ***sufficient***. In other words, the institution is in compliance with the objectives of internal control that guarantee adequate management and control of savings deposits. It is important for readers to analyze the reasons that any internal control objectives did not receive the maximum possible score, evaluate the impact this has on the institution, and make corrections or implement controls that would enable the institution obtain the maximum score.

Score between 40 and 60 points

A score between 40 and 60 points means that the internal controls applied for the deposit cycle are ***reasonable***. They are, however, ***insufficient*** and need to be improved. Each internal control objective listed in the first column should have at least one accompanying control procedure. The additional control procedures related to each objective should be implemented within a reasonable time period. Most of the procedures should be performed on a daily basis. Cash counts and reviews can be performed monthly. Readers should re-evaluate their institutions within a short time to see if the score has improved and take action as appropriate.

Score of less than 40 points

A score of less than 40 points means that the controls applied for the deposit cycle are ***deficient***. Readers should act now to establish internal control systems in their own institutions. All highlighted controls should be implemented as soon as possible to ensure adequate management of savings deposits. The remaining controls should be implemented within a reasonable time period. Readers should re-evaluate their institutions within a short time to see if the score has improved and take action as appropriate.

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TOOL 4 An Introduction to Liquidity and Asset-liability Management

Monnie M. Biety

When a formerly credit-only microfinance institution (MFI) starts raising voluntary savings and using those deposits to finance the loan portfolio, the liquidity and asset-liability management of the institution becomes more complex. The institution not only has to deal with the fluctuating demand and varying interest rates and terms on loans, but also with erratic deposit demands and withdrawals and changing interest rates and terms on savings. Liquidity and asset-liability management in savings institutions requires a coordinated, planned approach.

Liquidity Management

Liquidity refers to the ability of an institution to meet demands for funds. Liquidity management means ensuring that the institution maintains sufficient cash and liquid assets (1) to satisfy client demand for loans and savings withdrawals, and (2) to pay the institution's expenses. Liquidity management involves a daily analysis and detailed estimation of the size and timing of cash inflows and outflows over the coming days and weeks to minimize the risk that savers will be unable to access their deposits in the moments they demand them. In order to manage liquidity, an institution must have a management information system in place—manual or computerized—that is sufficient to generate the information needed to make realistic growth and liquidity projections. The information needed includes:

- The actual deposit liabilities of the MFI as of a certain date according to client name, maturity, amount, and type of account.

- A history of deposit and loan inflows and outflows.
- A history of overall daily cash demands to determine the amount of cash that needs to be kept on-site and in demand deposit type accounts.

A liquidity shortage, no matter how small, can cause great damage to a savings institution. It takes a long time to build client relationships, a liquidity crisis can destroy those relationships instantly. In order to avoid a liquidity crisis, management needs to have a well-defined policy and established procedures for measuring, monitoring, and managing liquidity.

Liquidity Management Policy

A savings institution should have a formal liquidity policy that was developed and written by the officials with the assistance of management. The policy should be reviewed and revised as needed, no less than annually. The policy should be flexible, so that managers may react quickly to any unforeseen events. A liquidity policy should specifically state:

- Who is responsible for liquidity management.
- What is the general methodology of liquidity management. How will liquidity be monitored or, in other words, what liquidity management tools will be used. What are the time frames to be used in cash flow analysis, the level of detail, and the intervals at which the cash flow tools used are to be updated.
- The level of risk that the institution is prepared to take in minimizing cash to enhance profitability. Specifically, the policy should establish minimums and maximums for total cash assets and for the amount to be kept on-site.
- How often decisions about liquidity should be reviewed, including: assumptions used to develop the cash flow budget, the minimum cash requirement as described in daily cash forecasting, and any of the established ratio targets.
- The signatory authority limits of the liquidity manager should excess cash be on deposit at another institution. Often liquidity decisions need to be made rapidly to avoid a crisis; therefore the liquidity manager should have some

authority. This authority should have limits; for example, another signature should be required for unusually large transactions. If liquid funds are not invested in another financial institution or other type of investment, then there should be very specific policies on how excess funds are to be handled, such as who has access to them and where they are to be kept.

- Which assets are considered to be liquid.
- Established limits for the maximum amount to be invested in any one bank, to limit exposure to a bank failure.
- Who may access or establish a line of credit for short-term liquidity needs.
- What are acceptable reasons or scenarios for accessing the line of credit.

Liquidity and Asset-liability Management

Asset-liability management (ALM) is the process of planning, organizing, and controlling asset and liability volumes, maturities, rates, and yields in order to minimize interest rate risk and maintain an acceptable profitability level. Simply stated, ALM is another form of planning. It allows managers to be proactive and anticipate change, rather than reactive to unanticipated change.

An MFI's liquidity is directly affected by ALM decisions. Managers must always analyze the impact that any ALM decision will have on the liquidity position of the institution. Liquidity is affected by ALM decisions in several ways:

- Any changes in the maturity structure of the assets and liabilities can change the cash requirements and flows.
- Savings or credit promotions to better serve clients or change the ALM mix could have a detrimental effect on liquidity, if not monitored closely.
- Changes in interest rates could impact liquidity. If savings rates are lowered, clients might withdraw their funds and cause a liquidity shortfall. Higher interest rates on loans could make it difficult for some clients to meet interest payments, causing a liquidity shortage.

Asset-liability Management

As an institution begins to mobilize savings the ALM challenges increase dramatically. Most savings institutions offer several types of savings products. Each product type has varying attributes and reacts differently to market changes; the challenge of ALM lies in the differing characteristics of each product.

The objective of ALM is to maintain a match in the terms of rate sensitive assets (those assets that will move in search of the most competitive interest rates) with their funding sources (savings, deposits, equity, and external credit) in order to reduce interest rate risk while maximizing profitability. Interest rate risk is defined as the risk that changes in the current market interest rates will adversely impact the institution's financial performance. For example, due to changes in the market an MFI is forced to adjust the interest rate on deposits upward to remain competitive, but its earning assets are concentrated in long-term, fixed-rate loans, and investments. Financial performance will be impaired because the institution cannot adjust its income earned on loans upward as fast as the cost of funds is increasing. Interest rate risk to some degree is unavoidable, but it is manageable.

Interest rate risk may increase in the following scenarios:

- When longer-term fixed-rate loans and investments are funded with deposits that are short-term and can be repriced quickly or that have variable interest rates with short-term adjustment periods. For example, a one-year fixed-rate loan is funded by certificates of deposit with three-month maturities.
- In an environment of high or unpredictable inflation. If clients deposit their funds in an institution when inflation is high, they still expect to earn a real rate of return. In order to pay a real rate of return, the institution must earn enough on its assets to pay a real rate of return on its liabilities. This scenario requires that managers constantly monitor interest rates and make adjustments to assets and liabilities in a timely fashion. The effect of inflation would be exacerbated if the rates on loans and investments were fixed and deposits were short-term or with variable interest rates.

- If the assets and liabilities have a high sensitivity to interest rate changes. Assets and liabilities which are considered highly sensitive to interest changes include: lines of credit and bank loans, large deposits, and any deposits being paid above market interest rates.
- When the local market is competitive. Competition usually reduces the margin between the interest rate charged on loans and the rate paid on deposits. In a competitive environment, the institution may not be able to increase rates earned on loans or lower the rate paid on deposits without affecting client demand and the profitability of the institution.

Managers should strive to reduce or manage the effect interest rate risk will have on the institution's profitability. There are numerous ways that management can reduce interest rate risk. Loans and investments can all have short-term maturities (nothing with a maturity greater than one to three months). As loans are repaid and deposits mature, then the interest rates can be adjusted as needed to maintain profitability. This is by far the simplest approach. The shortness of the term allows management to eliminate interest rate risk, but may impact profitability, since this approach reduces the type of loans and savings products that may be offered and the level of service provided to clients.

If the institution has the capacity, managers can use variable interest rates to manage risk. Variable rates allow the institution to grant longer-term loans as long as managers have the ability to change interest rates on a monthly or quarterly basis. With variable interest rates, the client assumes the risk on loans if rates should increase and the MFI assumes the risk of increasing rates on deposits.

Interest rate risk can be managed by matching the maturities and interest rates of loans and investments with the maturities and interest rates of deposits, equity, and external credit in order to maintain adequate profitability. This is known as gap management, or the management of the spread between interest rate sensitive assets and interest rate sensitive liabilities.

Lastly, if an institution accepts deposits in a foreign currency in addition to the local currency, it must be able to loan or invest those funds in assets denominated in the same foreign currency. If not, then foreign exchange risk becomes a serious problem.

Monitoring the ALM Position

In order to successfully monitor the ALM position of a savings institution:

- Managers must have effective liquidity management plans in place.
- Managers must be able to identify the core or stable deposit base in the institution and match that against longer-term assets to reduce the interest rate risk. Stable deposits include: equity, certificates of deposit with penalties for early withdrawal, retirement savings, savings with a stated purpose, and regular savings accounts with small balances. Within each savings account type managers must determine the amount or percentage of funds that can be used to fund longer-term loans.
- Managers must be able to identify the minimum net margin (gross income – cost of funds) necessary to fund financial costs, operating expenses, and contributions to capital.

All of this can be accomplished if the institution has (1) an effective management information system—manual or computerized—that provides the necessary data; (2) formal, written liquidity and ALM policies, (3) tools in place to monitor liquidity, the gap position of the institution, the core deposits, and the net margin; and (4) a commitment by both officials and managers to change both deposit and loan interest rates as demanded by the local market.

ALM Policy

As in all operational areas, ALM must be guided by a formal policy that was developed and written by the officials with the assistance of operational management. The policy should be reviewed by officials annually and revised as needed. The ALM and liquidity policies may be two separate policies or one comprehensive policy. In any case, the ALM and liquidity policies cannot be written in isolation, as decisions on lending, investments, liabilities, and equity are all interrelated. The ALM policy should discuss:

- Who is responsible for monitoring the ALM position of the institution.
- What tools will be used to monitor ALM.

- How often the ALM position will be analyzed and discussed with officials and management.
- What are the acceptable parameters or ranges for ALM ratios or indicators.

In addition, management must have established the following to strengthen ALM:

- Short and long-term minimum capital or equity/total assets goal ratios.
- The maximum percentage of assets to be held by any one client, in different types of loans and investments, in fixed-rate investments and loans with a maturity greater than one year, and invested in fixed assets.
- The desired diversification of savings and deposits to eliminate potential concentration risk (having too much in any one type of deposit or with any one client).
- Maximum maturities for all types of loans, investments, and deposits.
- Establishment of fixed or variable interest rate loans and deposits.
- Pricing strategies for loans and savings products that are based on what it actually costs to offer the products and what the local market will bear.

Liquidity management, ensuring that the institution maintains sufficient cash plus liquid assets to meet withdrawal and disbursement demands and pay expenses, is essential in savings mobilization. ALM, the process of planning, organizing, and controlling asset and liability volumes, maturities, rates, and yields in order to minimize interest rate risk and maintain an acceptable profitability level, is another key component of savings mobilization. The two are very closely tied. A savings institution must have effective liquidity and asset-liability management in order to ensure that low-cost funds will always be available for savers when they demand repayment of their funds deposited.

Most of the text in this tool was excerpted from: Biety, Monnie "Liquidity and Asset Liability Management," in *Savings Services for the Poor: An Operational Guide,* ed. Madeline Hirschland, 2003. Washington, D.C.: PACT Publications. Parts of this text were taken from: Biety, Monnie *Operational Guidelines for the Development and Early Stages of Credit Union Operations,* 1998. Madison, Wis.: World Council of Credit Unions, Inc.

Tool 5 Monitoring and Projecting Cash Flow

Hector Noriega

Monthly Cash Flow Statement

The cash flow statement reports the cash inflows and cash outflows of an institution during a set period. It indicates where the cash came from and how it was spent. The cash flow statement also explains the causes of any changes in the cash balance.

The purpose of the cash flow statement is to:

- Present all cash inflows and outflows for a given period (normally monthly);
- Serve as a tool to estimate future cash flow;
- Reveal the impact of management decisions;
- Determine the capacity to pay dividends and/or interest on shares, and the interest and principal on loans payable; and
- Disclose the relationship of profits as changes occur in the cash balance.

For matters related to the cash flow statement, the word *cash* refers to cash accounts, checking accounts in banks, and cash equivalents such as short-term investments that can be easily converted into cash at any given time.

Notes:

Operating Activities correspond to accounts that form part of Net Profit (income and expenses), and also to the accounts of Earning Assets, Non-earning Assets, Short-term Liabilities With Costs, and No-cost Short-term Liabilities.

Investment Activities correspond to long-term asset accounts, both earning and non-earning.

Financing Activities correspond to the accounts of Long-term liabilities (with and without costs) and Capital accounts (net worth).

NAME OF INSTITUTION ______________________

Cash Flow Statement

For the Period ______________________

Increase or (Decrease) in Cash and Cash Equivalents

CASH FLOW FROM OPERATING ACTIVITIES		
INCOME ACTIVITIES		
Cash Sales (products or services)		
Recovery of Accounts and Notes Receivable		
Recovery of Loans Receivable		
Loans Payable - Short-term, and Savings Deposits Received		
Interest, Commissions, Monetary Adjustments, and Dividends Received (from any source: loans, investments, etc.)		
Other Income (fees, rent, photocopying, etc.)		
Total Cash Income		
EXPENSES (CASH DISBURSEMENTS)		
Cash Payments to Creditors		
Disbursements (net of repayments) of Loans Receivable and Withdrawals		
Payments of Loans, Accounts, and Notes Payable		
Payments to Employees (salaries, benefits, training, etc.)		
Payments of Accrued Expenses Payable		
Payments of Interest, Commissions, and Monetary Adjustments		
Marketing Expenses (announcements, publicity, promotions, etc.)		
Representation Expenses (for the board and committees)		
Administration Expenses (per diem, maintenance and repairs, services, materials and supplies, rent, taxes, etc.)		
Other Administrative Expenses (and general expenses)		
Total Cash Disbursements		
Income (Expense) Net of Operating Activities		
CASH FLOW FROM INVESTMENT ACTIVITIES		
Sale (Purchase) of Fixed Assets and Real Estate		
Investments (+ sale, - purchase)		
Deferred Expenses (+ repayment, - new expenses)		
Income (Expense) Net of Investment Activities		
CASH FLOW FROM FINANCING ACTIVITIES		
Share Contributions (Required and Voluntary) (+ sales, - return)		
Long-term Loans Payable (+ received, - amortizations)		
Donations Received		
Payments of Dividends		
Income (Expense) Net of Financing Activities		
Net Increase (Decrease) in Cash		
Plus: Cash Balance (beginning date of period)		
Cash Balance on (ending date of period)		

Signatures: Manager ______________________

Accountant ______________________

Date ______________________

Projecting Cash Flow

Projected cash flow reports give an account of the expected cash inflows and cash outflows of an institution during a *future* period. It indicates where the cash will originate and how it will be used.

Projected cash flow reports are used to determine:

- If there will be sufficient liquidity to cover financial costs, personnel expenses, marketing expenses, legal fees, administrative expenses, disbursements of new loans, savings withdrawals, share contributions, loans payable, and creditors;
- Future management decisions with regard to savings mobilization; and
- The need for external financing.

Again, for matters related to the projected cash flow, the word *cash* refers to cash on hand, cash held in other financial institutions, and also to short-term investments owned by the institution. Readers can use the following table to project the cash flows in their own institutions.

The projected cash flow report *does not* include operations or transactions that do not affect cash on hand or cash held in other financial institutions. It does not include, for example, Interest Receivable or Monetary Adjustment on Investments (against Earned Income accounts); Interest Payable or Monetary Adjustment on Loans Payable, or on Deposits (against Interest Costs or Monetary Adjustments); Accumulated Expenses Payable; Donations (in-kind or fixtures and real estate); interest credited to share accounts and savings deposits of clients; or Depreciation and Amortization.

Cash Inflows

Income in the form of cash receipts is described below.

Loan Interest Income Collected: This is the loan interest and monetary adjustments that an institution collects in cash from loans granted to clients. (In some countries, a monetary adjustment is collected to maintain the value of the domestic currency equal to one U.S. dollar.)

Fees Income Collected: These are the fees and delinquency charges that an institution collects in cash on loans granted to clients.

Investment Income Collected: This is the interest earned and monetary adjustments on savings accounts, certificates of deposit, and other instruments, that an institution receives from banks and other financial institutions on either short- or long-term investments that the institution owns.

Income Collected From Non-Financial Investments: This is income received in cash for non-financial investments. This type of cash income should be rare, since savings institutions should specialize only in financial intermediation.

Other Income (fees, rent, photocopying): This is income that an institution receives from charges such as fees paid by new clients (or members), rent from real estate owned, or the sale of photocopying services.

Recoveries of Loans: This is the recovery of principal in cash that was loaned out to clients.

Recoveries of Accounts Receivable: This is the recovery in cash of the accounts receivable.

Savings and Deposits Collected: These are savings and deposits received by the institution.

Income from Share Contributions (new members or additional shares): These are required and voluntary share contributions collected by a credit union from its members.

Cash Donations: These are cash donations received by an institution that are used to purge the uncollectible portfolio, pay wages or salaries, or for any other reason.

Sale of Fixed Assets: This is cash income that an institution earns in cash when it sells a fixed asset, such as in the sale of a building.

Sale of Investments: This is the amount that an institution earns in cash when it sells an investment that it has on the books.

Other Income Collected: This line is to register the cash income from any source not specifically mentioned in the previous lines.

New External Credit (Notes Payable): These are the subsidized funds that an institution receives from private international donor organizations.

Cash Outflows

Expenses in the form of cash disbursements are described below.

Payments to Creditors: These are payments made by an institution to its distributors and creditors in order to pay down or pay off the amount owed for the purchase of merchandise on credit.

New Loans Granted: These are cash disbursements made by an institution to clients as loans receivable.

Purchase of New Investments: These are sums paid in cash by an institution to purchase short and long-term investments. The investments may be in savings accounts, certificates of deposit, reserves, deposits in a second tier organization or in the Central Bank, securities, or others.

Purchase of Non-Financial Investments: These are amounts paid in cash by an institution for the purchase of short and long-term non-financial investments.

Savings and Deposit Withdrawals: These are the amounts paid by an institution in cash for client withdrawals of savings.

Shares Withdrawals: These are payments in cash made by a credit union for the withdrawals of member shares.

Payment of Notes Payable: These are payments on external credit that an institution owes to external financial institutions and international donors.

Interest Paid on Deposits: This is the interest, including monetary adjustment, that an institution pays on passbook savings and fixed-term deposits. (In this case, the institution pays out a monetary adjustment to maintain the value of domestic currency against one U.S. dollar.)

Interest Paid on Notes Payable (or Loans): This is the interest, monetary adjustments, and commissions that an institution pays on external credit.

Interest Paid on Accounts Payable: This is the interest that an institution pays on accounts payable.

Interest or Dividends Paid on Share Contributions: This is the interest, including the monetary adjustment, that a credit union pays in cash on share contributions. These costs are not included if the credit union only credits the amount in the account of each member.

Payment for Deposit Insurance: These are the costs that an institution pays for deposit insurance on current savings, fixed-term deposits, and share contributions.

Personnel Expenses: These are all personnel expenses, such as salaries and benefits, that an institution pays in cash for its employees.

Marketing Expenses: These are marketing expenses such as announcements or publicity, which an institution pays in cash to build an institutional brand and promote services and products.

Representation Expenses: These are expenses that an institution pays in cash for things such as the Annual General Assembly, board of directors' meetings and expenses, and those of other committees.

Administration Expenses: These are all the expenses that an institution pays in cash to run its operations, such as professional services, maintenance and repair, fuel, materials and supplies, rent, and taxes.

Losses Due to Cash Shortage, Robbery, Fraud: All projected cash losses caused by theft, assault or fraud. This *does not* include losses of office equipment, materials and supplies, or other fixed assets.

Expenses Related to Repossessed Assets: These are expenses that an institution pays in cash when it acquires an asset through the repossession of collateral.

Purchase of Fixed Assets, Furniture, and Equipment: This is the purchase of any kind of fixed asset in cash. This *does not* include purchases on credit, which should appear under the line item of Accounts Payable.

Pre-paid Expenses: These are the expenses paid in advance in cash to acquire office supplies, or for insurance premiums, rent, or publicity.

Other Pre-paid Expenses: These are the expenses paid by an institution in cash for any reason that is not specified in the previous line items.

PROJECTED CASH FLOW

INSTITUTION NAME

CALENDAR OF PROJECTED MONTHS	1	2	3	4
	JANUARY	FEBRUARY	MARCH	APRIL
INITIAL CASH BALANCE AND BANK ACCOUNTS				
CASH INFLOWS				
Loan Interest Income Collected				
Fees Income Collected				
Investment Income Collected				
Income From Non-Financial Investments				
Other Income (Member fee application, rent, photocopy)				
Recoveries of Loans Receivable				
Recoveries of Accounts Receivable				
Savings and Deposits Collected				
Income From Shares (New member or new share deposits)				
Cash Donations				
Sale of Fixed Assets				
Sale of Investments				
Other Income Collected				
New External Credit (Notes Payable)				
Total Cash Inflows				

	JANUARY	FEBRUARY	MARCH	APRIL
CASH OUTFLOWS				
Payments to Creditors				
New Loans Granted				
Purchase of New Investments				
Purchase of Non-Financial Investments				
Savings and Deposit Withdrawals				
Shares Withdrawals				
Payments of Notes Payable				
Interest Paid on Deposits				
Interest Paid on Notes Payable				
Interest paid on Accounts Payable				
Interest/Dividends Paid on Shares				
Payment for Deposit Insurance				
Other Cost of funds/Interest paid				
Personnel Expenses				
Marketing Expenses				
Representation Expenses				
Administration Expenses				
Losses due to Cash Shortage, Robbery, Fraud				
Expenses related to Repossessed Assets				
Purchase of Fixed Assets, Furniture, & Equipment				
Pre-paid Expenses				
Other Prepaid Expenses				
Total Cash Outflows				
Total Net Cash Flow				
Final Cash Balance and Bank Accounts				
EXTERNAL CREDIT ANALYSIS				
Initial Balance External Credit				
+ Withdrawals				
- Repayments				
Ending Balance External Credit				

ASSUMPTIONS:

5	6	7	8	9	10	11	12
MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER

MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER

TOOL 6 Calculating the Net Margin

Hector Noriega

What is Net Margin?

The net margin tool should be an important component of an asset-liability management program. The net margin tool provides a picture of how well the financial institution is covering its cost of funds and operating expenses with its earnings on assets.

The definition of *net margin* is all sources of revenue less the cost of funds and operating expenses. Net margin provides a broader picture than *net interest margin*, which measures all interest earned and collected from loans and investments less the cost of funds. The principal difference between the two concepts is that other sources of income and operating expenses are included in the net margin calculation so that a net spread between all assets and liabilities is computed.

The net margin (percentage or amount) should always be positive. A positive net margin signals that the financial institution is generating sufficient income from its assets to cover the cost of funds paid on savings products and on other sources of funds, as well as its operating expenses. A negative net margin means the opposite, that the institution is not generating enough income to cover costs. The measurement of yield on assets and cost of funds on liabilities can also provide managers with a tool to measure the efficiency of their own financial institution compared to competitors in the same market.

Managers should run the calculation of net margin regularly to monitor whether or not the institution is covering its costs, since a change in either assets or sources of funds will change the outcome. The following table presents a simple mechanism to calculate the net margin.

Using the Tool

1. The amounts for Net Loans, Cash, Investments, Other Assets, Fixed Assets, Current Liabilities, Dividends Payable, Demand and Fixed-term Deposits, Programmed Savings, Capital, and Net Income are taken directly from the institution's balance sheet and entered into the first column.
2. In the second column, the asset mix is calculated by dividing each asset by the total assets. The Mix column shows managers what percentage each asset makes up of total assets. In this example, Net Loans make up 75 percent of assets, Cash is 0.40 percent of assets, Investments are 22.47 percent of assets, Other Assets are 0.52 percent, and Fixed Assets are 1.60 percent of assets.

   The cost of funds Mix is calculated by dividing each source of funds by the total funds. Current liabilities make up 0.63 percent of funds, Dividends payable (in credit unions) 0.34 percent, Demand and Fixed-term Deposits 91.34 percent, Programmed Savings 0.25 percent, Capital 7.24 percent, and Net Income 0.19 percent.
3. The example assumes data as of April; therefore, the annualized rates are calculated by multiplying the income/asset by 3. The annualized interest rate on loans is 8.23 ($1,283,448) and the annualized return on investments is 2.47 percent ($115,209). In the third column the total income earned on assets is calculated to be $1,398,697.

   The annualized rates on liabilities are calculated by multiplying the cost/liability by 3. The annualized rate paid out on demand savings deposits and fixed-term deposits is 3.60 percent. The annualized rate paid out on Programmed Savings is 4.35 percent. The total cost of funds is $684,997.
4. The Gross Spread is calculated by subtracting the total paid out on Demand and Fixed-term Savings ($682,752) and Programmed Savings ($2,245) from the income earned on Total Assets ($1,398,697). The Gross Spread in this example is $713,700.
5. The Net Margin is calculated by subtracting Operating Expenses ($594,351—taken directly from the Statement of Income) from Gross Spread. In this example, the Net Margin is $119,349, or 0.57 percent.

With a positive Net Margin, the financial institution in this example is covering its costs.

INSTITUTION
Yield on Assets
As of DATE

ASSETS		MIX	INCOME	ANNUALIZED RATE
Net Loans	46,771,027	75.00%	1,283,488	8.23%
Cash	250,200	0.40%		
Investments	14,011,266	22.47%	115,209	2.47%
Other Assets	326,141	0.52%		
Fixed Assets (Net)	999,129	1.60%		
Total Assets	**62,357,763**	**100.00%**	**1,398,697**	**6.73%**

COST OF FUNDS			COST	
Current Liabilities	394,017	0.63%		
Dividends Payable	210,183	0.34%		
Demand and Fixed-term Deposits	56,960,274	91.34%	682,752	3.60%
Programmed Savings	154,794	0.25%	2,245	4.35%
Capital	4,516,901	7.24%		
Net Income	121,595	0.19%		
Total Cost of Funds	**62,357,763**	**100.00%**	**684,997**	**3.30%**
GROSS SPREAD			**713,700**	**3.43%**
Less Operating Expenses			594,351	2.86%
NET MARGIN			**119,349**	**0.57%**

TOOL 7 Risk Analysis in Savings Mobilization

Nelson Aldana Arroyo

Risk analysis and risk management are necessary to ensure the continuing safety and soundness of a financial intermediary dedicated to capturing savings. What is understood by "risk?" *Risk is the chance or possibility of damage or loss.* In the context of savings mobilization, risk is *the danger caused by an event or a loss that could impair the value of savings on deposit or substantially affect the net worth of the institution.* To prevent this kind of damage from occurring, managers must actively manage risks. For the most part, risk management consists of:

- Identification and evaluation of existing risks;
- Decision-making regarding new transactions and changes in the risk profile, in relation to how much profit will be obtained for the assumed risk; and
- Analysis of results from above and action to manage the risks.

A principal function of risk management is to ensure an adequate ratio of profitability to assumed risk, and to bring that ratio in line with the institution's goals for liquidity, soundness, and solvency.

In order to attract the volume of resources necessary to fund operations, financial intermediaries rely on three main sources of funds:

- Savings mobilization;
- External credit from outside entities; and
- Shareholder or member capital.

Each option carries risks for the institution as well as for the source of the funds. Creditors, investors, and the institution all assume risk when the institution obtains external credit or raises capital from shareholders. Savings mobilization implies risks for the institution and serious risks for its clients: it puts clients' money at risk.

This tool will address some of the major risks assumed by institutions that mobilize savings as their primary source of funds: liquidity, exchange rate, and reputation risk.

Liquidity Risk

A savings institution can continue to operate only to the extent that its clients *trust* that the entity will be able to fulfill its obligations and repay savings either upon demand or upon fulfillment of fixed-term contracts. Liquidity refers to the ability of the institution to obtain the liquid funds required to be able to return the full value of deposits, plus interest, to savers as well as meet the withdrawal demands of borrowers and cover the institution's expenses. Liquidity risk stems primarily from the possibility of a mismatch in the cash inflows and cash outflows between assets and liabilities.

Opinions vary on the levels of liquidity required to manage risk. The challenge lies in finding the balance of having sufficient liquidity to be able to meet withdrawal and disbursement demands, but not so much that the institution loses income that could have been earned on the funds that were kept liquid. The *PEARLS International Standards of Excellence* suggest that institutions should maintain a minimum of 15 percent of Short-term Investments + Liquid Assets – Short-term Payables/Savings Deposits, and 10 percent of Liquidity Reserves/Savings Deposits. Non-earning liquid assets should constitute no more than 1 percent of total assets.

While liquidity ratios serve as good indicators of risk, managers should not rely solely on ratios to evaluate their degree of exposure to liquidity risk. The reason for this is that liquidity indicators can be deceptive; even though they may appear to be positive or sufficient, they can be reduced quickly by mismatched maturities, composition, or concentration of assets and liabilities. At a minimum, managers must evaluate cash flow and the balance between assets and liabilities to monitor and manage liquidity risk. One way that managers can determine the degree of liquidity risk exposure in their institution is by comparing the maturities of liabilities to the maturities of assets and identifying any gaps or margins. A gap analysis signals the amount of resources necessary to face a possible withdrawal of deposits.

In addition to establishing adequate liquidity levels, risk management includes building lines of defense or contingency plans, to minimize potential liquidity problems. Lines of defense can include: lines of credit with other financial institutions, adequate levels of provisions or liquidity reserves, and the establishment of conditions such as a repurchase guarantee or the possibility of immediate liquidation of medium- and long-term financial investments. These types of contingencies would provide the funds necessary for an institution to meet immediate, or unexpected, withdrawal demands without experiencing a liquidity crisis.

Savings institutions should strive to maintain a stable deposit structure, both in terms of product type and account size. Savings products with fixed terms facilitate liquidity management. Term deposits provide relative stability, whereas liquid savings accounts which are payable on demand can exert pressure on the institution's liquidity position at any given time.

An evaluation of the concentration level of deposits identifies the pressure that a few large depositors could exert on the liquidity and profitability of the institution. The evaluation of large-account concentration risk should review the level of concentration both by number of depositors and by points of service (or branch offices). The institution should strive to diversify the sources of funds (or depositors) to reduce the large-account concentration risk. Additionally, institutions can maintain higher liquidity reserves for savings accounts above a certain threshold to mitigate the large-account concentration risk; for example, an institution may have a standard liquidity reserve of 15 percent of total savings deposits, and then a liquidity reserve of 25 percent of total savings deposits for accounts above the threshold.

Exchange Rate Risk

Exchange rate risk arises when the real value of assets, liabilities, and obligations held in a foreign currency are adversely affected by changes in the domestic exchange rate. Of course, this risk is greater in countries characterized by unstable exchange rates. Savings institutions may attract deposits in a currency that maintains its real value; for example, some credit unions in Guatemala offer savings accounts in both U.S. dollars and the local currency of quetzales. However, if the savings institution does not place those funds in instruments of the same currency in which they were deposited, and if the exchange rate experiences a negative change, the institution will incur losses when savers withdraw their funds.

To manage exchange rate risk, financial institutions need to balance the funds received in foreign currency, in both amounts and terms, with investments in that same currency. Another option for managing this risk is to create a risk reserve in the foreign currency that is equal to but not greater than 10 percent of institutional capital. In the case of a loss, the 10 percent of capital reserves would be there to absorb it.

Reputation Risk

Reputation risk stems from the public perception of an institution. Reputation risk can be particularly damaging for financial intermediaries, since savings mobilization requires earning the trust of depositors, creditors, and the public at large. Reputation risk is very difficult to measure, but must be monitored constantly. It takes time for a savings institution to build a trustworthy reputation in the local market. This reputation can be ruined instantly if the institution does not manage risks adequately. As a clear example, clients will lose confidence in the institution if they are aware of a liquidity crisis, and are likely to transfer their savings to another institution or to an alternative form of savings as a result.

Tools for Analyzing Risk

Cash Flow and Gap Analysis

The following table can be used to determine the degree of liquidity risk where deposits are not matched appropriately with assets that can be easily liquidated. The table will bring to light if the institution lacks sufficient lines of defense to provide coverage for potential withdrawals of funds. Additionally, the table allows users to evaluate the appropriateness of either increasing or decreasing the terms for attracting funding sources, depending on the liquidity position of the institution.

The assets should be listed by maturity date, according to how easily the institution can access the funds—starting with the most liquid (cash or demand deposits, for example) and ending with the least liquid (such as fixed assets or accounts receivable that are not easily liquidated in the short term). Likewise, liabilities should be classified according to their terms of payout. Assets and liabilities that do not have definite terms, but that are considered liquid or withdrawable, should be included in the analysis, input according to the ease of liquidation of the asset or the expected payout of the liability.

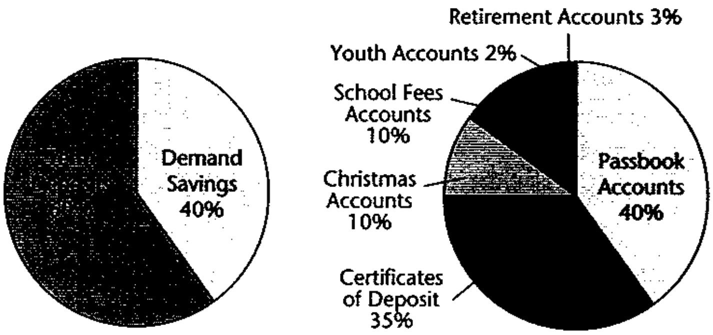
	Maturity Term							
Description	Immediate	1 Month	2 to 3 Months	3 to 6 Months	6 to 12 Months	1 to 2 Years	2 to 5 Years	More than 5 Years
Assets								
Cash								
Institution's Deposits								
Demand								
Term								
Investments								
Loans								
Other Assets								
Subtotal								
Liabilities								
Client Deposits								
Current								
Term								
Other Obligations								
Credit								
Capital								
Subtotal								
Gap								
Gap %								

Once the gap, or gap percentage, has been determined, managers can then analyze which term represents the greatest risk of deposit withdrawal. Managers can then decide how to resolve the mismatch and better evaluate the lines of defense the institution that has in place to meet potential withdrawal demand. Additionally, this simple table provides managers with a foundation for establishing a liquidity management plan. It should be noted that a gap does not necessarily reflect problems, because managers can implement a plan to deal with eventual withdrawals and the deficiency can be minimized. The table should be analyzed in relation to the lines of defense set up and the institution's liquidity management plan.

This type of table can also be used to analyze an institution's exchange rate risk in its asset-liability management. It can help managers to identify potential liquidity problems in a foreign currency, allowing them to prevent eventual profitability problems that could result from a currency mismatch or changes in the exchange rate. Managers of an institution that offers products in two currencies should create two tables to analyze the cash flow and gap in each currency and ensure that liabilities are covered by assets of the same currency.

Deposit Structure

The deposit structure analysis is simple—managers review the balance sheet in order to determine the composition of the deposits in the institution according to their potential for withdrawal; that is, demand savings versus term deposits. In the structure analysis, managers establish the percentage that each type of deposit should contribute to the total amount of deposits (the percentage should be set out in formal liquidity management policies). In terms of liquidity management, a safe deposit structure is one in which term deposits represent at least 50 percent of total deposits. Managers might create a pie chart that displays the breakdown of deposits to get a clear picture of the deposit structure. In the following example, the first pie chart separates term deposits from demand savings, while the second chart breaks out the deposits by product.



Monitoring Account Concentration

The large-account concentration risk must be evaluated constantly, since the rapid withdrawal of one or more large accounts could impact the liquidity position and profitability of the institution. If large volumes of funds are held within a few large accounts (which tend to be interest rate sensitive and relatively volatile), withdrawal could leave the institution with insufficient liquidity to meet withdrawal and disbursement demands.

To monitor the large-account concentration risk, managers can create a table to classify deposits by account balance and by points of service (branch offices). The following table provides a tool to monitor account concentration. The table is organized in descending order, from the largest balance to the smaller balance accounts. The balance of total deposits in each branch office goes in the first column. The balance of the five largest savings accounts in each branch office is entered into the second column. In the third column, the balance of the five largest accounts is divided by the balance of total deposits to calculate the percent of total deposits that the five largest accounts constitute. The same steps are followed throughout the table to find the balance of the 50 largest accounts and determine what percentage of total deposits they make up. The balances are added for the first 5, 10, 20, 30 and 50 accounts, meaning that the 10 largest accounts will include the first 5, the 20 largest will include the 10 largest, and so on. This kind of analysis enables managers to evaluate the degree of exposure the institution has to the withdrawal of funds by the largest depositors.

Branch	Balance of Deposits	Balances in the Largest Accounts 5	%	10	%	20	%	30	%	50	%
Central Office											
Branch No. 1											
Branch No. 2											
Branch No. 3											
Consolidated											

The analysis is broken down by branch office, because despite the fact that the central office may be able to rescue a branch that has a short-term liquidity problem due to a deposit withdrawal, a high degree of large-concentration in one branch can affect the liquidity position of the institution as a whole. The risk is even greater if the consolidated large-account concentration is high, or if various branches have large stocks of funds in just a few large accounts.

This tool has examined the principal risks assumed by institutions that mobilize savings as their primary source of funds: liquidity, exchange rate, and reputation risk. Managers should monitor the institution's deposit structure to ensure that deposits are collected in a combination of account types with varying maturity periods. The tables presented for a simple cash flow and gap analysis and a large-account concentration analysis can be applied to detect, manage, and minimize the impact that these risks can have on the institution.

TOOL 8 Profit and Loss Simulation Model

José Linares Fontela

This tool presents a simple profit and loss simulation for a programmed Christmas account. The model tracks the incoming funds from the monthly deposits and the channeling of those funds into loans. It then projects the income generated by the loan accounts. Finally, it projects the profit or loss on the savings and loans and also the return on the portfolio.

For this product, savers deposit $50 per month from January through November. If the saver completes all of the 11 deposits, the institution pays the 12th installment of $50. If a saver misses a deposit during those 11 months, he or she does not receive the full 12th installment. All of the savings accounts are withdrawn on December 15th, just in time for Christmas. The model assumes that out of the 1,000 savers who use the product, 10 percent deposit only half of the required installment each month.

The account receives a monthly deposit of $50 (line 1). The net balance runs a cumulative total of the account balance (line 2). The savings, less the provisions for loan losses, are used to fund loans (line 3). The model assumes that 10 percent of loans are delinquent and that provisions are created for 100 percent of delinquent loans.

In the first month, the amount placed in loans (line 4) is $50 minus the 10 percent provision, or $45. The monthly income on the loans is calculated with an interest rate of 18.5 percent (line 5). In the second month, the amount placed in loans is calculated by summing the amount placed in loans the previous month, the income earned on those loans, and the new monthly deposit of $50, for a total of $95.69. In the third month, the amount placed in loans is calculated by adding the amount placed in loans in all previous months, the income earned on those loans during the previous month, and the new monthly deposit of $50, for a total of $147.17. The calculation continues and funds are loaned out until December, when funds are placed in loans only until mid-December (and only half of the monthly income is earned).

The profit and loss per account is calculated for each month (line 8) by subtracting the financial cost on the savings (line 6) and the estimated operating costs of managing the savings and loans (line 7) from the income earned on the loans (line 5). The model assumes that operating costs are 2 percent of the net balance of the account divided by 12 months. The profit on the account grows each month until December, when the financial cost of $50 is paid out.

The profitability of the total portfolio is calculated for each month (line 12) by adding the income earned on the loans financed by the 900 complete deposits, less the operating and financial costs associated with those accounts, plus the income earned on the loans financed by the 100 incomplete deposits, less the operating and financial costs associated with those accounts. After all accounts have been paid out in December, the total profitability on the portfolio is calculated by

PROFIT AND LOSS SIMULATION MODEL

	Months of the Program				
Analysis Per Account	January	February	March	April	May
1 Monthly Deposit	50	50	50	50	50
2 Net Balance	50	100	150	200	250
3 Balance Less Provision	45	90	135	180	225
4 Amount Placed In Loans	**45.00**	**95.69**	**147.17**	**199.44**	**252.51**
5 Income (Interest is compounded)	0.69	1.48	2.27	3.07	3.89
6 Financial Costs	0	0	0	0	0
7 Operating Costs	0.08	0.17	0.25	0.33	0.42
8 Profit/Loss	**0.61**	**1.31**	**2.02**	**2.74**	**3.48**
Portfolio Analysis					
9 % of Delinquency (variable)	0	10	10	10	10
10 Complete Deposits	1,000.00	900	900	900	900
11 Incomplete Deposits	0	100	100	100	100
Profit/Loss					
12 Profitability of the Portfolio	610.42	1,234.85	1,905.41	2,587.60	3,281.59
13 Return on the Portfolio					

All amounts in U.S. dollars.

summing the profitability of all 12 months. The projected profit on this account is $2960.91.

The return on portfolio (line 13) is calculated by dividing the total profit earned over the 12 months by the total amount placed in loans during the first half of December. The projected return on the portfolio is 0.50 percent.

Conditions	
Monthly savings	$50
Number of accounts	1000
Incomplete deposits	10%
Incomplete deposits equal half of required monthly deposit	$25
Interest rate on loans	18.50%
Operating costs	2%
Provisions for delinquency	10%
Savings program maturity date	December 15th

Months of the Program

June	July	August	September	October	November	Dec. 15th	Total
50	50	50	50	50	50	0	
300	350	400	450	500	550	550	
270	315	360	405	450	495	495	
306.41	**361.13**	**416.70**	**473.12**	**530.41**	**588.59**	**647.67**	
4.72	5.57	6.42	7.29	8.18	9.07	4.54	57.20
0	0	0	0	0	0	50	50.00
0.50	0.58	0.67	0.75	0.83	0.92	0.92	6.42
4.22	**4.98**	**5.76**	**6.54**	**7.34**	**8.16**	**-46.38**	**0.79**
10	10	10	10	10	10	10	
900	900	900	900	900	900	900	
100	100	100	100	100	100	100	
							Profit/Loss
3,987.56	**4,705.70**	**5,436.20**	**6,179.25**	**6,935.03**	**7,703.75**	**-41,606.46**	**2,960.91**
							0.50%

Tool 9 Creating a Marketing Campaign

Gerardo Morales

Readers can use the following tables to create and evaluate their own local marketing campaigns. The first table sets out 60 actions for creating an effective marketing campaign. In the next table, readers can evaluate their existing and potential strategies for creating a promotional campaign in their local markets, drawing on the 60 actions set out in the first table. Lastly, readers can use the pie chart to determine the promotional mix used in their own institutions.

60 ACTIONS FOR CREATING AN EFFECTIVE LOCAL MARKETING CAMPAIGN

PUBLICITY

- ☐ Local radio
- ☐ Promotional banners
- ☐ Signs in commercial areas
- ☐ Traveling megaphone announcements
- ☐ Distribution of product brochures
- ☐ Dispensers with brochures
- ☐ Local T. V.
- ☐ National T. V.
- ☐ Billboards
- ☐ Signs for people passing by
- ☐ Monitors with advertisements
- ☐ Local newspapers
- ☐ Publicity in special supplements
- ☐ Internet web page
- ☐ Stickers for cars
- ☐ Calendars at the end of the year
- ☐ Lighted signs on building
- ☐ Publicity items: hats, pens, key chains
- ☐ Publicity in public buildings, schools, sports centers, local markets

SALES PROMOTION

- ☐ Raffles with special prizes, according to the savings category
- ☐ Raffles for account opening
- ☐ Advertisements on special days: Teacher's, Secretary's, Mother's, Father's, Christmas
- ☐ Informative events in areas far from the points of service
- ☐ Meetings with special clients
- ☐ Information stands at events with large numbers in attendance
- ☐ Raffles in educational centers
- ☐ "Lightning" promotion of 1 day
- ☐ Menu of services in customer service areas
- ☐ Children's Club
- ☐ Raffles with instant prize
- ☐ Scratch-off coupons with instant prizes

PUBLIC RELATIONS

- ☐ Sponsoring of local events: your own fair, socio-cultural events
- ☐ Sending birthday cards to special clients, local opinion leaders
- ☐ Sporting events, co-sponsoring with leading brands of other industries
- ☐ Support for educational centers that promote the children/youth savings program

INDIVIDUAL AND GROUP SALES

- ☐ Selection and training of business promoters
- ☐ Sales to current clients
- ☐ Sales to potential clients
- ☐ Sales to inactive clients
- ☐ Marketing to organized groups with potential for saving
- ☐ Group marketing according to affinity: homemakers, merchants
- ☐ Intensive sales
- ☐ Portfolio of services for salespeople
- ☐ Objectives manual for salespeople
- ☐ Business cards for promoters
- ☐ Letters to parents with youth savers
- ☐ Cross-marketing of services: savings, loans, insurance
- ☐ Selective contact by e-mail
- ☐ Telemarketing

CUSTOMER SERVICE / CONTACT PERSONNEL

- ☐ Personnel focused on customer service
- ☐ Uniformed, motivated, and well-trained personnel
- ☐ Bilingual personnel as appropriate
- ☐ Offering candy and other items in the customer service area
- ☐ Clean and orderly image of the customer service area
- ☐ Comfortable environment for customer service: air conditioning, cold and hot water, coffee, well-lit space
- ☐ Competitive hours of service
- ☐ Create a "special service window"
- ☐ Service on holidays
- ☐ Opening of home collection accounts
- ☐ Anticipated marketing on fixed-term accounts before they mature

MY STRATEGIES FOR CREATING AN EFFECTIVE MARKETING CAMPAIGN

INSTRUCTIONS: Assuming the role of marketing director of your institution, select the actions from the 60 actions listed on the previous page that you would consider most appropriate to develop and penetrate your local market.

PUBLICITY

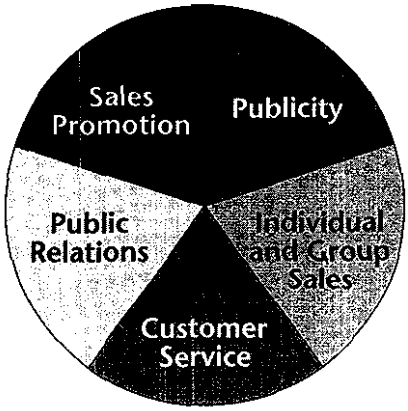
SALES PROMOTION

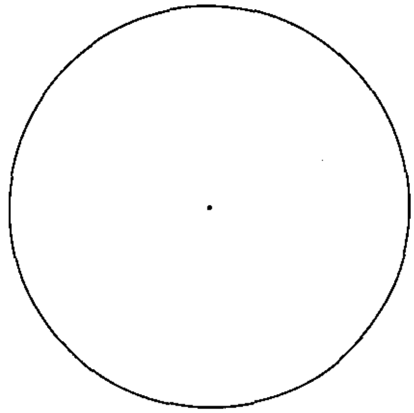
PUBLIC RELATIONS

INDIVIDUAL AND GROUP SALES

CUSTOMER SERVICE / CONTACT PERSONNEL

WHAT IS THE PROMOTIONAL MIX IN MY INSTITUTION?





INSTRUCTIONS: Classify the marketing activities performed in your institution, according to what you learned as you completed the worksheet.

Indicate the make-up of your promotional mix, expressed in terms of estimated percentages that total 100%.

< 333'

TOOL 10 A Guide to Designing Surveys

José Linares Fontela

Market research is a key component in the process of developing and marketing savings products. Among the most useful market research tools is the survey. This section describes how to develop, administer, and analyze a survey in seven steps:

1. Decide if a survey is the right tool.
2. Select the appropriate type of survey.
3. Define the *universe* and the *sample*.
4. Design the questionnaire.
5. Train staff and administer the questionnaire.
6. Use software to process the data.
7. Write a report of the findings and conclusions.

1. Decide if a Survey is the Right Tool

The first step is to decide if a survey is the right tool for the situation. There are three *advantages* to conducting a survey:

- **Precision:** The information gathered is fairly precise, usually within a 5 percent error rate.
- **Classification:** The information can be classified by geographical area, market segment, institution, etc.
- **Valuable conclusions:** Surveys can focus on specific data and relationships to yield valuable conclusions that managers and the marketing department can use to better define an institution's market strategies.

Surveys also have some *disadvantages*:

- **Cost:** Since they involve many resources, surveys can be costly.
- **Experience required:** A survey must be designed and administered by experienced professionals.
- **Limited information:** The questions covered in a survey are primarily "closed;" that is, the information is predefined and the answer options are limited.

2. Select the Appropriate Type of Survey

Managers must decide exactly what type of information they want to find out in order to decide which type of survey is appropriate for the situation. Among the survey techniques are:

- **In-person interview**
    - In private locations, such as homes or workplaces;
    - People passing by on the street; or
    - People in a particular place, such as visitors to the financial institution.
- **Brief versus in-depth**
- **Telephone interview**
- **Mail survey**
- **Internet form**

The survey technique is selected based on (1) the type of information an institution needs to gather, and (2) the amount of resources available for conducting the survey. Brief in-person interviews of people passing by on the street are less expensive than in-depth interviews in homes or workplaces, but the information gathered may be less detailed. Telephone interviews are less expensive than in-person interviews, but they will be limited to people who have telephones and it may be difficult to verify that the selected sample is actually the person answering the questions. A mail survey is even less expensive, but there is no way to assure that the survey will be filled out and returned. An Internet form survey is also inexpensive, but it is limited to only those who have Internet access.

3. Define the *Universe* and the *Sample*

As the type of survey is selected, the *universe* and the *sample* are defined.

The universe is the whole population to which the survey conclusions will apply. An accurate definition of the universe is important because an inaccurate definition will lead to incorrect conclusions, even if the research has been well conducted. If the universe is too large, then the cost of the survey will be higher and the conclusions less specific. For example, if the objective of the research is to find out about client behavior, then the information should be collected only from existing clients. The results obtained would be valid only for clients, and could not be applied to the general public.

Once the universe has been defined, the samples (or interviewees) are identified so that the survey questions are asked of people who fit into the universe conditions. For example, if the universe is defined as people who are clients, then every interviewee must be an existing client. Surveys completed by non-clients would not supply usable information.

The precision of the results will depend on the sample size and the way the samples are selected by the interviewer. The following characteristics should be considered in identifying the samples:

- **Sample size:** The sample size can be estimated using statistical tables that set out the level of confidence in the responses and the expected error rate. Cost is also a factor. The most expensive survey is a census, where 100 percent of the universe is interviewed. A smaller sample involves fewer interviews and, therefore, costs less. At the same time, a smaller sample yields a lower level of confidence and a higher error rate. Creators of the survey must find the appropriate balance between the cost and the confidence level and error rate. If the conclusions will be sorted into categories, the smallest sample should be 30 for any category.
- **Sample identification in the field:** Confidence levels and error rates are affected by the method used to select interviewees. All the members of a universe must have the same probability of being chosen as a sample. This is achieved through random selection. For example, a street block has 30 houses and the survey requires six samples from that block. The interviewer selects the first house at random and then every fifth house

after that. Starting with house #1, the interviewer would also visit houses #6, #11, #16, #21, and #26 on the block. The same method applies to selecting people passing by. The interviewer decides, for example, to interview every fourth person. Once the first person is selected at random, then interviewer talks with every fourth person. Starting with person #3, the interviewer would then talk with persons #7, #11, #15, #19, and so on, until the appropriate number of samples has been obtained.

- **Sample collection supervision:** The interviewer should obtain at least the name and telephone number of the interviewee when conducting a telephone or passers-by survey. The name and address should be obtained for a geographically defined sample. This information aids the survey analysts in verifying that the interview took place with right sample, and that the survey was properly completed by that sample and no other.

4. Design the Questionnaire

There are three steps to designing an effective questionnaire or survey:

1. Define the scope of the information to be obtained.
2. Determine the order of the questions.
3. Decide what type of question formats will obtain the information needed.

Scope of the information to be obtained: A preliminary checklist should be created to list all the issues to be explored in the questionnaire. This early checklist will be useful in defining the scope of the information that will be gathered with the survey. At this stage, the order of the questions is not important. A checklist for a survey could look something like this:

- Universe: People who have at least one account in a financial institution but who are not existing clients
- Type of accounts they hold
- Names of institutions where they hold the accounts
- Balance of the accounts

- Client's rating of the institution based on each of these criteria:
  - Service quality
  - Points of service
  - Financial products and services menu
  - Rates
- Expectations about the services they would like to receive from their own financial institution
- Ranking of the three best financial institutions in the local market in terms of:
  - Service quality
  - Points of Service
  - Financial products and services menu
  - Rates
- Sample's (interviewee's) profile
  - Gender
  - Age
  - Education level
  - Occupation
  - Marital status

Each issue on the checklist should be converted into a question that will be asked in the survey.

The order of the questions: The questions must be ordered in such a way so that answering one question does not influence or bias the answer of a later question. For example, if the interviewer asks which financial institution is preferred and then asks the interviewee to rank institutions, the first question will influence the answer to the second question. Or, if the interviewer first asks questions about the institution sponsoring the survey, those questions will influence the interviewee's opinions of the institution when he or she is asked to compare it with other institutions.

The question formats: Questions can be written in several formats. Some types are more effective than others, depending on the type of information sought in the survey.

- **One-option question:** This is the most basic type of question. The interviewee is asked to select one of two answers; for example, yes or no, male or female.
- **Several-option question with one answer:** This type of question gives the interviewee several answering options, of which the interviewee must choose only one option; for example, age range (20-29, 30-39, etc.) or income range ($100-$499 per year, $500-$999 per year, etc.).
- **Several-option question with more than one answer:** This type of question gives the interviewee several options, and permits more than one answer; for example, what type of accounts does the interviewee have in financial institutions (savings, checking, loans, certificates of deposit, etc.) or which financial services the interviewee would like to receive from the financial institution (savings, direct deposit, loans, etc.).
- **Ranking question:** This question asks the interviewee to order or rank several options; for example, from first to last, or from best to worst.
- **Weighted question:** This question asks the interviewee to order or rank options, assigning a number value or weight to each possible answer. Several answers can have the same weight, unlike ranking questions where no two answers can have the same position.
- **List question:** This is an open question in which the interviewee is asked to list a minimum number of answers in his or her own words; for example, "list three advantages of the financial institution where you keep your account," or "list two services you would like a financial institution to offer." Analysts must group these types of answers by similarities when tabulating; for example, a certificate of deposit may be the same as a term account, or a retirement account may be the same as a programmed account.
- **Open question:** This question asks the interviewee to describe something; for example, "describe a savings account." No more than 5 percent of the survey question should be open questions.

A survey that is conducted by telephone or given to people passing by should be no longer than 30 questions (plus the profile questions). If the questionnaire is given in a place where the interviewee and the interviewer can sit comfortably, it can be as long as 50 questions (plus the profile questions).

When extensive information is required, it may be more effective to design two or more surveys. While additional questionnaires will incur more costs, more precise information will be obtained. A survey with too many questions may cause interviewees to become tired or bored, and could prevent them from completing the questionnaire or providing accurate information as a result.

5. Train Staff and Administer the Questionnaire

A questionnaire must be tested before it is administered to the full sample population. As the testing is conducted, the staff or hired interviewers must be trained in how to conduct the survey. After collecting all the completed questionnaires, managers must validate that the appropriate samples were interviewed and that all surveys are complete.

Pilot testing the questionnaire: Before giving the questionnaire to interviewees, a controlled and limited survey should be conducted to identify difficulties with any of the questions. The pilot survey results should be analyzed to check for any problems. Pilot testing should ensure that the questions are written clearly and that there will be no bias toward any answers. Some aspects to consider in the evaluation of the pilot test are:

- Are the questions ordered logically?
- Are the questions easy for interviewees to understand?
- How long will it take to complete the questionnaire?
- What difficulties may interviewees have in completing the questionnaire?
- How will one question affect the answer of a subsequent question?

Training the interviewers: The interviewers should be trained in how to administer the survey. Interviewers must know the purpose of each question and how to ask the questions without suggesting responses.

They must be able to communicate clearly with the interviewees and know how to properly record the answers.

Conducting the interviews: All interviewers must follow the same procedures when administering the survey, so that results will not be skewed by individual practices. The interviewers must:

- Follow the selection methodology.
- Avoid influencing answers by making comments or giving opinions.
- Be patient with the interviewees.
- Encourage the interviewees to answer all the questions.
- Remain as objective as possible.

Validating the results: Once the interviews are complete, someone other than the interviewer should validate at least 20 percent of the surveys. This is done in order to ensure that:

- The interviewer actually did distribute the questionnaire.
- The interviewees were the right samples to complete the survey.
- The information was not invented. (If the interviewees did not complete the questionnaire, sometimes interviewers will complete the surveys themselves.)

If problems are identified in several surveys administered by one interviewer, all the questionnaires by that interviewer must be discarded or the analysis will be invalid.

6. Use Software to Process the Data

A commercial statistical program should be used to process the survey data. This type of software creates the charts and graphics needed to facilitate data interpretation and report writing.

Coding the answers: Once the surveys are validated, the answers that were not pre-coded must be coded and the information must be entered into the information processing system.

- Coding answers to open questions: Open questions will produce a variety of responses. Similar answers must be grouped and each kind of response must be assigned a code. This can be a difficult task, as the coder must interpret the responses and group those that are similar but worded differently.

- Coding answers to other types of questions: Other types of questions do not need to be specially coded, since the codes are written as part of the questionnaire. For example, if the first question has three possible answers, they are pre-coded 101, 102, and 103.

Producing frequency and percentage charts: The statistical software can be used to produce a series of frequency and percentage charts. The charts show the frequency and percentage for each answer. The charts will also show how the numbers are distributed as a quality control, enabling analysts to identify anomalies. The data can be ordered from the highest to the lowest number (or in other ways) to aid in data interpretation. Along with the number of responses for each answer, the software displays the percentage for each answer. The software will disregard "no response" answers in its tabulations.

Obtaining cross tabulations: The software reports response numbers for each question by frequency and percentage. It also analyzes the data by profile. For example, each question is analyzed by age, sex, income, or other identifying profile data. The software can cross tabulate the data of related questions. For example, it can compare a question about the financial services most frequently used with services most desired among a certain age group.

Generating statistics: The software produces many types of statistics; the average and dispersion data are generally most useful. These statistics allow analysts to view the answers that receive the highest number of responses and the ranges around which most of the data are clustered. Correlation measures are also useful, as they help analysts to identify cause-and-effect relationships between questions.

Desegregating the data: The software can be used to desegregate data in two ways: (1) It can "filter" the data, showing only specific information for one element; for example, for all interviewees with income above $500 (other information will not be shown). (2) The software can cross tabulate data, showing only data that correspond to the desegregated question. For example, it can display data for all branches that serve interviewees over age 60. Data desegregation allows analysts to identify the patterns in responses.

7. Write a Report of the Findings and Conclusions

In writing the final report, the analyst should include information about the relationship (or lack of relationship) between numbers, use charts and graphs to display data, and draw conclusions from the data obtained through the survey.

Looking for relationships: The analyst reviews the charts to identify relationships, either positive (when answers to one question grow as the answers to another question also grow) or negative (when answers to one question increase as the answers to another question decrease). Even if two questions are unrelated, the comparison can be important. The relative weight (percentages) of the answers is also important.

Including graphics: Converting the data into charts and graphs aids the readers in understanding the significance of the data and drawing conclusions from the patterns revealed. Graphs make data easier to comprehend. Frequency and percentage conclusions can be illustrated in pie graphs. Bar graphs are frequently used to show cross tabulations.

Drawing conclusions: An analyst who is familiar with the particular survey and experienced in reporting survey findings can often identify and report relationships that will help the product designers, managers, and marketers to make more effective decisions in the provision of savings services.

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Tool 11

Model Surveys

Gerardo Morales

This tool presents two model surveys. The first survey can be used to find out about the demographics of the local market. The second survey can be used to find out about the reputation of your institution in the local market. Readers should adapt the surveys to fit the needs of their own institutions.

FIND OUT ABOUT THE LOCAL MARKET

Good morning, my name is **NAME.** I work for **NAME OF SAVINGS INSTITUTION.**
I would appreciate it if you could give me ten minutes of your time.

I would like to ask you some questions about the savings and credit services provided by **NAME OF SAVINGS INSTITUTION.** We would like to learn what you think in order to be able to provide you with services that meet your needs.

GENERAL

1. What financial institution do you prefer to use here in **NAME OF TOWN?**
   Bank ____ Credit Union ____ NGO ____ Moneylender ____ Other ____________

2. Why do you prefer this institution?
   Security ____ Location ____ Hours of operation ____ Service ____
   Prizes/Promotions ____ Image ____ Other __________________

3. What type of services do you use from that institution?
   Passbook savings ____ Planned savings ____ Fixed-term savings ____ Loans ____
   Other __________________

   (Depending on answer to question 3, select questions 4 through 9)

SAVINGS

4. How frequently do you save?
   Monthly ____ Weekly ____ Daily ____ Other __________________

5. What interest rate are you paid for your savings?
   ____% Don't know ____

6. What do you save for?
   Security ____ Emergencies ____ Health ____ Housing ____ Purchase goods ____
   Education ____ To earn interest ____ To obtain credit ____ Other ____________

7. How much do you usually save each month?
   $0-25 ____ $26-50 ____ $51-100 ____ $101-250 ____ More than $250 ____

LOANS

8. How much interest do you pay for your loan?
   ____%
   Is that Annually ____ Monthly ____ Daily ____ Don't know ____

9. Do you know of any credit union here in **NAME OF TOWN?**
   Yes ____ No ____ (If "Yes") Which one do you know of? __________________

10. What is your opinion of this credit union?
    Excellent ____ Good ____ Bad ____

11. Have you heard of **NAME OF SAVINGS INSTITUTION?**
    Yes ____ No ____

(If the answer is "Yes", ask questions 12 and 13).

---

12. What have you heard or what is your personal opinion about **NAME OF SAVINGS INSTITUTION?**
    Good ___ Average ___ Bad ___

---

13. How did you hear about **NAME OF SAVINGS INSTITUTION?**
    Radio ___ Newspaper ___ Traveling megaphone ___ Fliers ___ Banners ___
    Friends/family ___ Other ______________

---

14. If **NAME OF SAVINGS INSTITUTION** were to open a branch here in **NAME OF TOWN**, what service would you be most likely to use initially?
    Savings ___ Loans ___ Other ______________ *(Specify)*

    (If the answer to above is "Loans," ask questions 15, 16, and 17; otherwise go directly to question 18.)

---

15. What would you use the loan for?
    Business ___ Housing ___ Agriculture ___ Education ___
    Personal Expenses ___ Other ______________

---

16. How much of a loan would you need right now?
    Less than $500 ___ Between $501 and $1,000 ___
    Between $1,001 and $5,000 ___ More than $5,000 ___

---

17. How would you like to pay off your loan?
    Monthly ___ Weekly ___ Daily ___ Other ______________ *(Specify).*

---

18. Would you like to receive a visit from a promoter of **NAME OF SAVINGS INSTITUTION,** so that you can learn more about the advantages of our services?
    Yes ___ No ___

    (If the answer is "Yes", ask the following question).

---

19. At what time would you like for us to visit?
    Morning ___ Afternoon ___ Evening ___ Weekend ___

Once the survey is completed, the interviewer asks for information about the interviewee, thanks the interviewee for taking the time to answer questions, and offers a promotional item from the institution. This information is useful to validate the survey and create a client and potential client database.

NAME ______________________________

ADDRESS ______________________________

OCCUPATION ______________________________

Name of the Interviewer ______________________________

Date ______________________________

FIND OUT ABOUT THE REPUTATION OF YOUR CREDIT UNION IN THE LOCAL MARKET

Good morning, my name is **NAME.** I work for **NAME OF CREDIT UNION.** I would appreciate it if you could give me ten minutes of your time. I would like to ask you a few questions about your knowledge of credit unions here in **NAME OF TOWN.**

---

1. Do you know about the existence of a new credit union here in **NAME OF TOWN?**
   Yes ____ No ____

   (If the answer is "Yes", continue with the interview)

---

2. Could you tell me the name of the credit union?
   ____

---

3. How did you learn about the arrival of the credit union?
   Radio ____ Cable TV ____ Traveling megaphone ____ Brochure ____ Flier ____
   Promoter ____ Other ______________

---

4. Where are their offices located?
   ____

---

5. Can you identify the logo of the credit union?
   (Show a poster board with three different logos, one of the credit union)
   Correct ____ Incorrect ____

---

6. Are you a member of the **NAME OF CREDIT UNION?**
   Yes ____ No ____

   (If the answer is "Yes", ask questions 7, 8 and 9;
   if the answer is "No", go directly to question 10.)

---

7. Which service have you used in the past or are you using now?
   Passbook Savings ____ Planned Savings ____ Fixed-Term Savings ____
   Loans ____ Other ______________

---

8. What is your opinion about this particular service?
   Excellent ____ Good ____ Average ____ Bad ____

---

9. How would you personally evaluate the image of **NAME OF CREDIT UNION?**
   Excellent ____ Good ____ Average ____ Bad ____

---

10. Why have you not joined **NAME OF CREDIT UNION?**
    Time ____ Distance ____ Image ____ Lack of security ____
    Lack of information ____ Requirements ____ Other ______________ *(Specify)*

---

11. Have you received a personal visit from a promoter of **NAME OF CREDIT UNION?**
    Yes ____ No ____

(If the answer is "yes," ask the following question)

---

12. How would you rate the visit from the promoter?
    Excellent ____ Good ____ Average ____ Bad ____

Once the survey is completed, the interviewer asks for information about the interviewee, thanks the interviewee for taking the time to answer questions, and offers a promotional item from the institution. This information is useful to validate the survey and create a client and potential client database.

NAME ____

ADDRESS ____

OCCUPATION ____

Name of the Interviewer ______________________________________

Date ____

Tool 12

Model Surveys

Juan Altamirano Obregón

This tool presents two model surveys. The first survey can be used to evaluate the effectiveness of a branding campaign. The second survey can be used to gather information about new savers in the institution. Readers should adapt the surveys to fit the needs of their own institutions.

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EVALUATE EFFECTIVENESS OF BRANDING CAMPAIGN

1. What publicity do you remember having heard, seen, or read recently about financial institutions?

   ____

   ____

   ____

2. For which financial institution was the publicity?

   ____

   Do not remember ____

3. In which medium did you see, hear, or read it?
   Television ____ Radio ____ Newspaper ____ Billboard ____
   Traveling megaphone ____ Do not remember ____

4. Do you think what the publicity says is true?
   Yes, it is true ____
   It is somewhat true ____
   It is not true ____
   Do not know ____

5. What publicity do you remember having heard, seen, or read recently about credit unions?

   ____

   ____

   ____

6. For which credit union was the publicity?

   ____

   Do not remember ____

7. In which medium did you see, hear, or read it?
   Television ____ Radio ____ Newspaper ____ Billboard ____
   Traveling megaphone ____ Don't remember ____

8. Do you think what the publicity says is true?
   Yes, it is true ____
   It is somewhat true ____
   It is not true ____
   Do not know ____

9. Which credit unions do you remember from the publicity?

   ____

   ____

   ____

Do not remember any ____ **(Go to question 11.)**

---

10. Can you tell me where these credit unions are located?

____

____

____

Do not remember ____

---

11. What mediums of communication do you see, listen to, or read daily?
    Television ____ Radio ____ Newspaper ____ Billboard ____
    Traveling megaphone ____ None ____

---

12. Gender
    Male ____ Female ____

---

13. Marital Status
    Married ____ Single ____ Divorced ____ Widowed ____

---

14. Age

    ____

---

15. Occupation

    ____

---

16. Monthly Income

    ____

---

17. What type of accounts do you hold?
    Passbook Savings ____
    Checking Account ____
    Planned Savings ____
    Fixed-term Certificate of Deposit ____
    Youth Savings Account ____
    Loans ____
    Other *(please explain)* ________________________

---

18. With which types of financial institutions do you have the accounts?
    Bank ____ Credit Union ____ NGO ____ Finance Company ____
    Other *(please explain)* ________________________

INSTITUTION NAME ________________ AGENCY ________________

Name of the Interviewer ________________________________

Date ____

GATHER INFORMATION ABOUT NEW CLIENT SAVERS

CLIENT NO. ____________________ ACCOUNT NO. ____________________

OPENING AMOUNT ____________________

---

1. Type of Account
   - Passbook Savings Account ____
   - Fixed-term Certificate of Deposit ____
   - Youth Savings Account ____
   - Planned Savings ____
   - Share Contribution ____

---

2. How did you find out about **NAME OF SAVINGS INSTITUTION?**
   - Radio ____
   - Newspaper ____
   - Billboard ____
   - Banner ____
   - Promotion/Prizes ____
   - Fliers ____
   - Visit from a promoter/officer ____
   - Traveling megaphone ____
   - Existing client referral ____
   - Director referral ____
   - Family/Friend referral ____
   - Walked by the institution ____
   - Other *(please explain)* ____________________

---

3. What is the principal reason why you chose to open an account in **NAME OF SAVINGS INSTITUTION?**
   Security ____ Location ____ Interest rate offered ____ Access to credit ____
   Other *(please explain)* ____________________

---

4. With which other types of financial institutions do you have accounts?
   Bank ____ Credit Union ____ NGO ____ Finance Company ____
   Other *(please explain)* ____________________ No other ____

---

5. What type of accounts do you have with other institutions?
   - Passbook Savings ____
   - Fixed-term Certificate of Deposit ____
   - Checking Account ____
   - Youth Savings Account ____
   - Planned Savings ____
   - Loans ____
   - Other *(please explain)* ____________________

---

6. Gender
   Female ____ Male ____

INSTITUTION NAME ____________________ AGENCY ____________________

Name of the Interviewer ____________________

Date ____________________

TOOL 13 Calculating the Costs of Savings Mobilization

David C. Richardson and
Oswaldo Oliva V.

The costing methodology presented in chapter 5 of this book offered readers a practical model for determining the costs of savings mobilization. The five tables that follow, taken directly from chapter 5, provide the framework for readers to start counting the costs of savings mobilization in their own institutions.

There are three main areas of outlays to consider when evaluating the total operating costs of a savings mobilization program: financial costs, direct administrative costs, and indirect administrative costs. Financial costs include: interest, insurance, taxes, and dividends. Direct administrative costs include: human resources, marketing, and commissions that are incurred as a result of savings mobilization. Indirect administrative costs related to savings mobilization include: human resources, administrative services, depreciation, and protection.

Table 1 is used to calculate the human resource costs related to savings mobilization, by adding up and annualizing the salaries and total benefits paid to employees and obtaining an estimate of the time dedicated to savings activities by position. The next two tables are used to calculate the allocation factors to be used later in the calculation of the indirect administrative costs related to savings. In Table 2, readers can calculate the percentage of total transactions that are related to savings by identifying all transactions and then breaking them out by service as a percentage of total transactions. In Table 3, readers can calculate the percentage of total physical space dedicated to savings activities by determining the total physical space of the institution and then identifying how much of each area is dedicated to savings activities.

Table 4 is used to sum the human resource costs included in the calculation of both direct and indirect administrative costs; the table calculates human resource costs by group, according to the positions set out in Table 1. The weighted average for each position is determined according to staff responses when asked about the percentage of time spent on savings activities. Readers can calculate the cost of each position related to savings mobilization by multiplying the average total compensation for each position by the average percent of the time spent on savings activities (determined by asking staff members directly and then weighting accordingly), calculating the total cost by position, and then the total costs by area of services.

Table 5 provides the framework for summarizing the financial costs, direct administrative costs, and indirect administrative costs related to savings mobilization. The total operating costs are taken directly from the profit and loss statement. One hundred percent of the direct administrative costs (financial costs, marketing, and commissions) are included in the calculation, since they are incurred directly as a result of savings mobilization. Each indirect cost area is calculated by multiplying the total operating costs by the related allocation factors that were calculated in Table 2 and Table 3. The human resource costs are carried over from Table 4. The last two columns of the table show the total operating costs related to savings mobilization, and then operating costs related to savings mobilization as a percentage of average savings volume.

TABLE 1 NOTES

[1] *Benefit paid to employees when they resign or are fired, equivalent to one pay check for every year worked plus the Christmas and 14th bonuses.*

[2] *A bonus paid to all employees at Christmas, equivalent to one paycheck.*

[3] *A bonus paid to all employees in the month of July, equivalent to one paycheck.*

[4] *A bonus paid to all employees when they take vacations, equivalent to 80 percent of one paycheck.*

[5] *This is a complement to the severance that an employee receives when leaving the organization, equivalent to 30 percent of the severance.*

[6] *This is an employer contribution to a retirement fund that all employees of credit unions share. The contribution in this credit union is 5 percent.*

[7] *Social security contribution of 7.83 percent of salary, paid by the credit union.*

TURN THE PAGE TO TABLE 1.

TABLE 1

	A	B	C = (A/B)	D	E
		Benefits			
Position	Salary	Severance[1]	Christmas Bonus[2]	14th Bonus[3]	Vacation Bonus[4]
Direct Administrative Costs					
Marketing Area					
Director of Marketing					
Marketing Technician					
Receptionist					
Tellers					
Head Teller					
Teller					
Teller					
Security					
Security Guard					
Security Guard					
Indirect Administrative Costs					
Management					
General Manager					
Assistant Manager					
Regional Office Manager					
Branch Office Manager					
Credit and Finance					
Director of Finance					
Director of Credit					
Director of Collections					
Loan Analyst					
Loan Collector					
Back Office Group					
Internal Auditor					
Chief Accountant					
Administrative Director					
Administrative Assistant					
Director of MIS					
Assistant Internal Auditor					
Auxiliary Accountant					
Computer Technician					
Support Services					
Janitors					
Messengers					
Total					

See notes to this table on page 355.

F	G	H	I	J	K	L
Benefits				Monthly Salary & Benefits	Annual Cost	Time Dedicated to Savings Mobilization
Economic Benefit[5]	Retirement Fund[6]	Social Security[7]	Benefits Subtotal			
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum B-H	A + I	J x 12	
			Sum of Column	Sum of Column	Sum of Column	

TABLE 2

Description	Amount	Total by Type	% of Total Transactions
Savings		Sum of Savings Transactions	Total Savings / Total Transactions
Deposits			
Withdrawals			
Open accounts			
Close accounts			
Transfers			
Replace passbooks and other			
Loans		Sum of Loan Transactions	Total Loan Transactions / Total Transactions
Disbursements			
Payments			
Others			
Other		Sum of Other Transactions	Total Other Transactions / Total Transactions
Debitor and creditor payments			
Insurance			
Total of transactions		Sum of Column	Sum of Column

Allocation Factor: This figure is to be used in Table 5

TABLE 3

Branch	A Lobby	B Tellers	C Marketing	D = (A+B+C) Subtotal Related to Savings	E Other Areas	F = (D+E) Total of Space
Main office						
02						
03						
04						
05						
06						
07						
08						
09						
10						
11						
Physical Space by Department	Sum of Column (in meters)	Sum of Column (in meters)	Sum of Column (in meters)	Sum of Column (in meters)	Sum of Column (in meters)	Sum of Column (in meters)
Percent by Department	Total Physical Space of Lobby / Total Physical Space of Building	Total Physical Space of Tellers / Total Physical Space of Building	Total Physical Space of Marketing / Total Physical Space of Building	Total Physical Space of Areas Related to Savings / Total Physical Space of Building	Total Physical Space of Other Areas / Total Physical Space of Building	Total Physical Space of Building

Allocation Factor: This figure is the allocation factor to be used in Table 5

TABLE 4

	A	B	C = (A/B)
		Compensation	
Position	Number of Persons	Total Compensation	Average of Compensation
Direct Administrative Costs			
Marketing Area			
Directors of marketing			
Marketing technicians			
Receptionists			
Tellers			
Head teller			
Tellers			
Security			
Security guards			
Indirect Administrative Costs			
Management			
General managers			
Assistant managers			
Regional office managers			
Branch office managers			
Credit and finance			
Directors of finance			
Directors of credit			
Directors of collections			
Loan analysts			
Loan collectors			
Back office group			
Internal auditors			
Chief accountants			
Administrative directors			
Administrative assistants			
Directors of MIS			
Assistant internal auditors			
Auxiliary accountants			
Computer technicians			
Support services			
Janitors and messengers			
Total			

D	E	F	G = (BxD)	H
Time Dedicated to Savings Activities				
Weighted Average % based on Staff Response	Minimum % based on Staff Response	Maximum % based on Staff Response	Cost by Position	Cost by Group
				H1 = (G1+G2+G3)
				H2 = (G4+G5)
				H3 = G6
				H4 = (G7+G8+G9+G10)
				H5=(G11+G12+ G13+G14+G15)
				H6=(G16+G17+G18+G19+ G20+G21+G22+G23)
				H7 = G24
				Sum of Column

TABLE 5

Cost Elements	Allocation Criteria
Average savings volume	
I. Financial costs	
Interest	Interest paid
Insurance	Insurance paid
Taxes on interest	Taxes paid
Shares dividends	Dividends paid
II. Direct administrative costs	
A. Human resources	
Marketing	% of time dedicated to savings activities
Tellers	% of time dedicated to savings activities
Security	% of time dedicated to savings activities
B. Marketing	
Advertising	Real costs of advertising
Promotion	Real costs of savings promotions
Studies	Real costs of market studies
C. Commissions	
Commissions	Commissions paid on new savings
III. Indirect administrative costs	
A. Human resources	
Management	% of time dedicated to savings activities
Back office and credit and finance	% of time dedicated to savings activities
Services support	% of time dedicated to savings activities
B. Administrative services	
Electricity, water, garbage removal	% of physical space occupied
Telecommunications	% of physical space occupied
Office maintenance	% of physical space occupied
MIS support	Transactions
Materials and supplies	Transactions
Vehicle mileage	% of time use of vehicles
Vehicle maintenance	% of time use of vehicles
Taxes	% of physical space occupied
C. Depreciation	
Buildings	% of physical space occupied
Vehicles	% of time use of vehicles
Office furniture	% of physical space occupied
Computerization	Transactions
Office rent	% of physical space occupied
D. Protection	
Robbery and general liability insurance premiums	Transactions
External audit and supervision fees	% of time of auditors and inspectors dedicated to savings
Property insurance premiums	% of physical space occupied
Provision cash shortfalls	Transactions
Total operating costs	

A Total Operating Costs	B Allocation Factor %	C = (A x B) Operating Costs of Savings Mobilization	D %
		Average Savings volume (1)	
		Sum of Financial Costs (2)	**2/1**
	100%		
	100%		
	100%		
	100%		
		Sum of Direct Admin. Costs (3)	**3/1**
		Sum of Human Resource Costs	
		Sum of Marketing Costs	
	100%		
	100%		
	100%		
	100%		
		Sum of Indirect Admin. Costs (4)	**4/1**
		Sum of Human Resource Costs	
		H4 Table 4	
		(H5 + H6) Table 4	
		H7 Table 4	
		Sum of Administrative Services Costs	
	Table 3 Allocation Factor		
	Table 3 Allocation Factor		
	Table 3 Allocation Factor		
	Table 2 Allocation Factor		
	Table 2 Allocation Factor		
	Record of Use of Vehicles		
	Record of Use of Vehicles		
	Table 3 Allocation Factor		
		Sum of Depreciation Costs	
	Table 3 Allocation Factor		
	Record of Use of Vehicles		
	Table 3 Allocation Factor		
	Table 2 Allocation Factor		
	Table 3 Allocation Factor		
		Sum of Protection Costs	
	Table 2 Allocation Factor		
	Estimated by Auditors & Supervisors		
	Table 3 Allocation Factor		
	Table 2 Allocation Factor		
Sum of Column		Sum of Column	Sum of Column

Contributors

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Brian Branch is vice president of World Council of Credit Unions, Inc. (WOCCU). He has been engaged in development, fieldwork research, and implementation for more than 22 years. He currently serves on the board of the *Agencia Calificadora de Instituciones WOCCU* and the WOCCU Services Group, Inc. Dr. Branch has worked with credit unions and other financial institutions for more than 13 years. He identifies and designs programs for the expansion and transfer of credit union financial service systems, organizations, policies, procedures, technologies, and management skills. He has implemented and managed institutional and financial field analyses of credit union movements in Bolivia, Costa Rica, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Honduras, Jamaica, Kenya, Mexico, Nicaragua, Peru, Poland, Trinidad, South Africa, Suriname, Uganda, and Vietnam. Dr. Branch is co-editor of *Safe Money: Building Effective Credit Unions in Latin America,* 2000. Dr. Branch holds a doctor of philosophy in Economics from the University of Wisconsin-Madison and a master of arts in Latin American Studies from the University of Texas-Austin. He received his bachelor of arts in Government and Spanish from Bowdoin College in Maine.

Oswaldo Cabezas Paredes is a management and financial consultant for the firm SPC Auditors and Consultants in Quito, Ecuador. He has over 20 years of experience working in financial management. In addition, he has experience as a university professor, a credit union trainer, and a consultant for the Confederation of German Cooperatives (DGRV). Dr. Cabezas has participated in a variety of courses and seminars addressing management and finance, and has worked on projects in Colombia, Costa Rica, Dominican Republic, Ecuador, Mexico, Nicaragua, Puerto Rico, and Venezuela. Dr. Cabezas holds a doctorate in Accounting and Auditing from the *Universidad Central del Ecuador* and a master of Management and Business Administration from the *Escuela Politécnica Nacional del Ecuador.* He also studied project administration and evaluation at *INCAE Centroamérica.*

Jesus R. Chavez is director of WOCCU's South Africa program, providing technical assistance to four savings and credit co-operatives (SACCOs). He was formerly WOCCU's financial service officer and director of WOCCU's Jamaica program, a project funded by the Inter-American Development Bank (IDB) to strengthen and stabilize credit unions and the credit union league in Jamaica. Before joining WOCCU, Mr. Chavez worked as a private consultant and president and CEO of White Sands Federal Credit Union, in Las Cruces, New Mexico. Prior to that, Mr. Chavez worked for 15 years as an examiner for the National Credit Union Administration (NCUA). During his last two years at NCUA, he worked directly for Chairman Norman D'Amours on a special project to bring credit union services to low-income areas in the United States. He has worked in various regions around the world, including South America, Central America, Africa, Central Europe, and the Caribbean. Mr. Chavez holds a bachelor of science in Business Administration from Winthrop University in South Carolina.

Mark Cifuentes is WOCCU's regional manager for Latin America, Caribbean, and Africa. He has more than 12 years of experience in international financial institution development. Mr. Cifuentes served as director of WOCCU's Rural Credit Union Program (RCUP) in Nicaragua for five years, where he was able to utilize his training and international experience to help 24 credit unions grow from insolvency, 64 percent delinquency, and no savings mobilization, to prosperous, savings-driven, safe and sound institutions. Mr. Cifuentes' work experience has taken him to more than 21 countries around the world, where he has carried out short- and long-term assignments with credit unions and other microfinance institutions. He has delivered presentations and conferences to managers, staff, and elected officials of financial institutions in subjects including: financial management, institutional development, regulation, marketing, and credit administration. He has also worked with various regulatory bodies in the development and setting of financial performance standards. Mr. Cifuentes holds a bachelor of science in International Relations from the University of Wisconsin-Madison.

César Izurieta Moreno is a consultant for WOCCU and an economist for the *Universidad Católica* in Ecuador. Mr. Izurieta provides technical assistance to credit unions in areas such as savings mobilization, credit services, marketing, and institutional development. Mr. Izurieta has extensive experience in providing implementation and training on the PEARLS Financial Performance Monitoring System and implementing business plans for credit unions. He created tools and trained practitioners in the use of *Credit Union Manual for Credit Policies and Procedures, Microenterprise Credit and Savings Products for Credit Unions,* the *PREMIO* personnel evaluation system, the *RATIOS2000* credit analysis system, and the organizational and administrative restructuring of credit unions. Mr. Izurieta has performed consultancies in Ecuador, Honduras, Mexico, and Paraguay. He holds a degree in Economics from the *Pontífica Universidad Católica* in Ecuador.

Janette Klaehn manages the Savings Best Practices and Cooperative Development programs for WOCCU, where she collects lessons learned in credit union savings mobilization programs in Latin America for dissemination to credit unions and other microfinance institutions throughout the world. Prior to joining WOCCU, Ms. Klaehn was an international trade specialist at the U.S. Department of Commerce. She also served as a Peace Corps Volunteer working in rural development in Guatemala. Before her tour in Guatemala, Ms. Klaehn worked at an information technology consulting firm in New York. Ms. Klaehn holds a master of arts in Latin American Studies from the School of Foreign Service at Georgetown University and a bachelor of arts in Political Science and Spanish from Tulane University.

José Linares Fontela is an independent consultant specializing in financial marketing, credit and collections, and savings mobilization. He is currently working on financial institution strengthening projects in the Dominican Republic, Honduras, Macedonia, Nicaragua, Peru, Rwanda, and Venezuela. Mr. Linares has extensive experience in providing technical marketing assistance to credit unions and microfinance institutions throughout Latin America. He has implemented projects in Latin America for WOCCU, the *Unión Interamericana de Ahorro y Préstamo para la Vivienda (UNIAPRAVI)*, USAID, the IDB, and the European Union, among others. He has taught classes in both undergraduate and graduate studies at the *Instituto Superior de Mercadotécnica (ISUM)*, the *Universidad Simón Bolívar*, and the *Universidad Metropolitana*, among others, in Venezuela. Mr. Linares has authored works published by the *Escuela de Alta Dirección y Administración (EADA)* in Barcelona, Spain and by the *Confederación Latinoamericana de Cooperativas de Ahorro y Crédito (COLAC)*. Mr. Linares holds a degree in Psychology from the *Universidad Católica Andrés Bello* in Venezuela and has completed graduate studies on savings institutions at the University of Missouri and the University of Wisconsin-Madison.

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Gerardo Morales manages marketing, research, and development for the *Federación Nacional de Cooperativas de Ahorro y Crédito (FENACOAC)* in Guatemala. Mr. Morales has more than 15 years of experience in institutional strengthening and development of credit unions in Latin America. Since 1990, he has been responsible for the Guatemalan credit union network's marketing and savings mobilization programs.

Mr. Morales also consults for USAID, the IDB, and various WOCCU programs. He has delivered lectures on topics that include marketing, savings mobilization, regulation, and microfinance. He holds a master of Business Administration with a focus on Marketing from the *Universidad Francisco Marroquin,* and bachelor's degree in Business Administration from the *Universidad de San Carlos de Guatemala.*

Hector Noriega is a principal credit union examiner for the National Credit Union Administration (NCUA), stationed in Miami, Florida. Previously, he served for five years as Financial Advisor for WOCCU's Rural Credit Union Program (RCUP) in Nicaragua. Mr. Noriega has also provided technical assistance to credit unions in WOCCU programs in Bolivia, Ecuador, El Salvador, Jamaica, Guatemala, Mexico, and Kenya, and has assisted the Superintendency of Banks in Bolivia and Ecuador with credit union supervision. Before joining WOCCU Nicaragua, Mr. Noriega held several positions at NCUA in New York City. He was responsible for the direct supervision of credit unions and then was later promoted to be a principal credit union examiner, which made him responsible for the direct supervision of complex, large-asset-sized credit unions with significant problems. Mr. Noriega was also a corporate examiner, supervising credit unions that serve as second tier organizations in the United States. He holds a bachelor's degree in Business Administration from the University of Puerto Rico, Rio Piedras, Puerto Rico.

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