MOBILIZING SAVINGS FROM THE PUBLIC

BASIC PRINCIPLES AND PRACTICES

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ACRONYMS AND ABBREVIATIONS

ADOPEM	Asociación Dominicana para el Desarrollo de la Mujer (Dominican Republic)
AFI	Alternative Financial Institution (an institution set up historically with an intent to reach poorer clients than those served by standard commercial banks)
ASCA	Accumulating savings and credit association
BRI	Bank Rakyat Indonesia
CD	Certificate of Deposit
CEO	Chief Executive Officer
CGAP	Consultative Group to Assist the Poor
DR	Dominican Republic
EBS	Equity Building Society (Kenya)
FIE	Fomento a Iniciativas Económicas (Bolivia)
K-REP	Kenya Rural Enterprise Programme
MCI	Microcredit institution
MFI	Microfinance institution
MIS	Management information system
NGO	Nongovernmental institution
PAR	Portfolio at risk
ROSCA	Rotating savings and credit association
SPEED	Support for Private Enterprise Expansion and Development
USAID	U.S. Agency for International Development
WWB	Women's World Banking

Mobilizing Savings from the Public:

Basic Principles and Practices

I. Collecting Public Savings: *Who, Why, What, When, Where, How?*

For microcredit organizations that have the leadership, vision, and skills to change their institutions fundamentally, transformation can be a route to viable long-term commercial microfinance—and to large-scale outreach to the poor.[1] But transforming to a regulated financial intermediary is not for the vast majority of financial nongovernmental organizations (NGOs) or other microcredit institutions (MCIs). Even for a strong MCI, the process of building a large-scale financial intermediary is considerably more difficult than is generally realized.

This paper concerns the challenges of collecting and intermediating voluntary savings from the public.[2] It has two aims. One is to help transforming MCI owners, boards, donors, managers, and staff members understand what to expect when introducing public savings facilities. The other is to inform their decisions about whether collection and intermediation of public savings is the right choice for their institution. The topics discussed here are also relevant for regulatory and supervisory authorities that license MCIs applying to become regulated financial intermediaries, and that must develop the capacity to supervise such institutions.

Although written primarily for transforming MCIs in developing countries, this paper can also be useful for financial institutions that are already intermediaries, but that want to enter the microfinance market. These include banks of various kinds, nonbank financial institutions, credit unions and financial cooperatives, and others—including some in developed countries. Such institutions can select the aspects of savings mobilization discussed here that may be most relevant for their particular needs (which will vary from one microfinance provider to another).

The 'Who' and 'Why' of collecting savings from the public are addressed in Part II where the focus is on the savers, and in Part III where the emphasis is on the microfinance institutions (MFIs). The 'What' and 'Where' of voluntary savings mobilization are examined in Part III, while the 'When' and 'How' questions are considered in Part IV. Part V then addresses the question: Who benefits from voluntary savings mobilization?

[1]The writing of this paper was supported by the USAID-funded Support for Private Enterprise Expansion and Development (SPEED) project in Uganda, and Chemonics, the implementing agency for the project; and by Women's World Banking. I am grateful to these organizations for their support. I would also like to thank Philip Broughton and Joanna Ledgerwood of the SPEED project, and Christine Killorin, Saiful Islam, and Fawzia Naqvi of Women's World Banking (WWB) for their varied and valuable contributions to this paper. I am grateful also to Hans Dellien and Aristoteles Esperanza of WWB for the information they provided for the discussion of the transformation process of the NGO ADOPEM to a regulated bank, discussed in the appendix. Special thanks to Joanna Ledgerwood for her careful and very helpful reading and comments on multiple drafts of the paper.

[2]In the banking industry a savings account refers to "money that is deposited in a bank, usually in small amounts periodically over a long period, and not subject to withdrawal by check", while the term deposit refers to "an amount of funds consisting of cash and/or checks, draft, coupons, and other cash items that may be converted into cash upon collection" (Rosenberg 1993, pp. 107, 308). Because these distinctions are not always relevant in the microfinance market and because others may be more important, the terms deposit and savings (when used to refer to accounts and services) are used synonymously here.

Part II starts the discussion by addressing the question, "What do savers want?" It explores the forms in which low- and lower-middle-income people save (in cash, gold, animals, etc.), the purposes for which they save (emergencies, managing irregular income streams, children's education, and the like) —and how they match savings forms to savings purposes. Evidence exists from around the world to show that many of the economically active poor who save in nonfinancial form will save in financial form if suitable institutions and instruments are available. Appropriately designed voluntary savings services delivered effectively at the local level are much in demand—because they permit poor people to store seasonal or temporary excess liquidity safely for future use and to increase income through returns on savings. And these savings are often the savers' only legally recognized assets. Large unmet demand for savings services is found throughout the developing world, and many opportunities exist for regulated MFIs to mobilize these savings.

Part III shifts the focus from client demand to commercial financial institutions that provide microfinance services, and to the basic principles that underlie the performance of industry leaders. Commercial microfinance refers to the delivery of small-scale financial services by self-sufficient institutions that finance their loans by various combinations of voluntary savings from the public, commercial debt, equity investments, and retained earnings. Interest rate spreads are set to permit institutional profits. The facilities provided are primarily for credit and voluntary savings, but they can also include other services such as remittances, fund transfers, payments, and insurance. Some microfinance providers specialize only in microfinance, while others serve a wide range of clients, including many low- and lower-middle-income people.[3] The term microfinance institution (MFI), as used in this paper, is broadly construed to mean an institution that provides microfinance services on a substantial scale, including both specialized and non-specialized institutions.

Experienced MFIs can operate profitably on a large scale, serving many clients, and financing all or most of their loan portfolios with savings.[4] But this requires clear ownership, high levels of skilled and knowledgeable governance and management, an organizational structure appropriate for commercial microfinance, and a corporate culture of transparency and accountability. It also requires extensive knowledge of the microfinance market (of which microcredit is only one part), expertise in financial intermediation among branches that may be located far apart, and experience in suitable investment strategies for excess liquidity.

However, among NGOs (or other MCIs) that are considering or planning a transition to a regulated financial intermediary, relatively few seem to have board members and managers who understand sufficiently the ways that public savings mobilization will affect the newly-regulated institution. Transforming MCIs typically have much to do to meet the licensing requirements of their regulatory authorities, and often the tendency is to put learning about voluntary savings on the back burner. Still, such institutions often expect to open savings services to the public shortly after being licensed as a financial intermediary. But learning to provide savings facilities to the public—including managing crucial organizational changes, recruiting new managers and staff, and training both old and new staff; upgrading information, reporting, accounting, treasury management, internal controls, security, and others; and pilot testing, costing and pricing products and services—takes considerably more time than is usually anticipated. For reasons discussed in Part IV below, it can take one to two years before a well-managed institution is ready to provide savings facilities to the public in all its branches.

[3]Institutions serving a range of clients include financial cooperatives and credit unions, rural banks, state-owned agricultural and development banks, postal banks, and others

[4]As used here, *large scale* means coverage of millions of clients in large countries. For smaller countries and for middle- and high-income countries with limited demand, large scale means outreach to a significant portion of the microfinance market. *Profitability* means covering all costs and risks without subsidy and returning a profit to the institution.

The most important first step for an MCI considering transformation is to acquire a full understanding of the basic principles that underlie successful voluntary savings mobilization from the public, including large numbers of low-income savers. These principles should also be incorporated by the regulatory authorities into their licensing and supervisory guidelines for MCIs transformed to deposit-taking institutions.

Ten basic principles for MFIs mobilizing voluntary savings from the public are discussed in Part III. One of these principles—that the introduction of savings facilities for the public requires careful sequencing—is discussed in detail in Part IV. The paper then concludes, in Part V, with a discussion of why voluntary savings matters for the development of the microfinance industry—and who benefits.

> *The single most important point that transforming MCIs must understand is that successful mobilization of public savings—including large numbers of low-income people—inevitably changes the institution fundamentally. Only financial institutions that are prepared for such change should open public savings facilities.*

II. What Do Clients Want?

Evidence from a wide range of countries, cultures, and economies shows that economically active poor savers want from their financial institutions pretty much the same things as most readers of this paper (and its author) demand from theirs. Low-income savers whom I have met—whether in India or Mexico, Uganda or Vietnam, Bolivia or Indonesia—all want essentially the same things: security, convenience, liquidity, confidentiality, products appropriate for their needs, helpful and friendly service, returns, and potential access to loans. And they want their financial savings to be a legally recognized asset—often the only one they have. These demands form a package—they are not a menu from which the MFI can choose. But MFIs that can deliver this package effectively can mobilize massive amounts of savings. And if they price their products right and operate efficiently, they can do so profitably.

Voluntary and compulsory savings

The term savings refers throughout this paper to voluntary savings unless otherwise specified. Voluntary savings products—which are what clients want—are fundamentally different from compulsory savings products, and they reflect widely disparate philosophies. MCIs that require compulsory savings as a condition of obtaining a loan generally assume that poor people must be taught to save, and that they need to learn financial discipline. In such institutions borrowers are often required to save in illiquid products, with their savings used by the MCI to finance its loan portfolio. Also, many MCIs treat compulsory savings as collateral, using the savings to cover missed loan payments. The compulsory savings approach typically provides clients with little or no choice of savings products (and often with no returns on their savings). And frequently the client has no access to her savings—except by foregoing her option to borrow from the institution. In addition, the client is usually not permitted to save unless she borrows. Thus, while raising the cost of their loans, compulsory savings do not meet the needs of most low-income savers.

In contrast, MFIs that emphasize the role of voluntary savings in microfinance typically assume that the economically active poor already save in a variety of forms, and that they do not need to be taught to save. Such clients do, however, need a choice of products—including an account that allows them to make unlimited withdrawals at any time during the hours the MFI is open (which should be set in relation to the clients' timing needs). Low-income people, as well as others, demand savings facilities that do not require them to go into debt in order to save. An institution aiming at collecting savings from the public, including substantial numbers of poor customers, needs to learn to provide a choice of savings products

and services appropriate for client demand. It has been well documented by commercial microfinance providers in different regions of the developing world that MFIs that can do so can profitably finance loan portfolios with large outreach using voluntary savings (supplemented with commercial debt as needed).

How and why poor people save—and how these savings can be mobilized by MFIs

Developing countries show considerable similarity in the ways poor people save in the informal sector, in the reasons they save, and in the ways they match the type of savings with the particular reason for saving.[5] The primary need of poor savers is to swap small savings from income flows for lump sums needed for a variety of purposes (Rutherford 2000a).[6]

MFIs that want to mobilize savings from low-income people must first understand in what ways and for what reasons poor people save—and what the savers like and do not like about each savings method used. The institution can then design and deliver financial products that will maintain those aspects of people's present savings methods that they like (for example, liquidity), and improve on those that they dislike (such as lack of security). Then the MFI can develop products and services that meet the needs of the poor better than they can do by themselves. And if the institution is successful in this effort, it is likely to draw large numbers of savers.

But large unmet demand remains for savings services (and credit) among low-income women and men in both rural and urban areas of developing countries. These potential clients include farmers, fishers, herders, artisans, traders, service providers, micro-industries, government and private sector employees, and many others.

As will be discussed, MFIs wanting to serve poor savers must also serve the nonpoor in order to raise the average account size (so that the institution remains profitable while serving large numbers of poor savers). Therefore the MFI must be aware of the financial habits and needs of the nonpoor as well as the poor. Potential savings clients include anyone who lives or works near an MFI branch. They range from the poor to the wealthy (who may have savings accounts in urban banks but who often like to keep some of their funds in a bank close to home). And they include institutions and organizations as well as individuals.

Similar types of informal savings methods are common to much of the world. The main difference is that some types of savings are more available or more valued in some places than in others. Forms in which people save typically include cash; grain and cash crops; animals; gold, silver, jewelry, and other valuables; rotating (and non-rotating) savings and credit associations (ROSCAs or ASCAs); raw materials and finished goods; construction materials; cash or grain lent out for profit; and deposits with informal savings collectors. The saver then matches as well as possible the form of savings with the purposes for which she is saving.

Three common types of informal savings mechanisms are discussed below. Like the others, each has its own advantages and disadvantages. Much (but not all) of the funds in these informal savings methods can be mobilized by commercial MFIs that understand the microfinance market and deliver appropriate products and services (see Robinson 2001, chapter 7).

[5]This section is adapted from Robinson (2001, chapter 7).

[6]For discussion of savings among low- and lower-middle-income people see, among others, Christen, Rosenberg, and Jayadeva (2004); Branch and Klaehn, eds. (2002); Robinson (2002a, 2001); Robinson and Wright (2002) ; Mutesasira (2000); Rutherford (2000a, 2000b); Wright (2000, 1999a); Hannig and Wisniwski, eds. (1999); MicroSave-Africa (1999, 2001d); Mutesasira and others (1999).

Cash savings. Keeping cash in the house is a very widespread form of saving among economically active poor people.[7] The primary advantages are that cash kept at home is liquid and convenient. Most people hold some cash in the house, primarily for emergencies, but also for other purposes such as managing irregular income streams, and for business opportunities that may arise unexpectedly. But saving in cash has serious disadvantages. The main one is lack of security. Another commonly reported disadvantage is that with cash on hand, it is difficult to avoid giving it or lending it to family, friends, and neighbors. Another disadvantage frequently mentioned is the temptation to use the cash for unnecessary expenses. A possible decline in the value of currency because of high inflation or devaluation is also a concern, especially in countries where there is current or recent experience of such events. Another drawback of saving in cash (but one rarely mentioned by poor savers) is the lack of returns. In some countries, such as Ghana and India, poor savers pay informal savings collectors to hold their money. Thus the saver earns negative interest.

How can cash savings be mobilized by MFIs? Most people will always keep some cash in the house, if they can. But many people keep more cash on hand than they want—because they do not know what else to do with it. These are potential MFI clients. In general, only savings accounts with no restrictions on withdrawals will draw cash savings kept for emergencies. And the MFI must be conveniently located near the saver's home or workplace. For the saver, the advantages of financial savings accounts are that they are legally recognized assets, and that the funds are secure, liquid, and in most cases earn returns (but the real value of savings held in the bank, as well as of cash held in the house, may decline because of inflation or currency devaluation).

Animals. Saving in animals is very common in rural areas (and sometimes urban dwellers keep animals with rural relatives as a form of saving). Rural households that can afford to do so typically keep a few large animals, such as cows, buffalo, horses, donkeys, goats, sheep, and pigs (except in Muslim areas). Poultry and other smaller animals are also common. There are numerous advantages to this form of saving: animals provide returns from propagation, they can usually be sold fairly quickly, and some provide by-products (milk, eggs, wool, labor). But leaving aside households that breed and sell animals as a primary economic activity, there are considerable disadvantages to using animals as a savings mechanism. Needed resources (grazing land, food, water, shelter, and labor) may be scarce. In some areas, theft is common. Floods and droughts may decrease or decimate savings held in animals. Where employment is available and children are in school, the opportunity cost of the time that household members spend in caring for the animals is widely recognized. And the liquidity problems caused by the indivisibility of large animals are clearly perceived. There is also the risk of an animal's illness or premature death.

People save in animals for a variety of purposes, including emergencies, managing irregular income streams, and some medium-term savings goals such as house renovation or children's education. Most rural households want to keep some animals. But beyond that, they often prefer financial savings—if there is a trustworthy institution available that offers products and services appropriate for their needs. They are then likely to open accounts and, if the service is good, to maintain them.

To save for emergencies, a passbook savings account with unlimited withdrawals will normally be selected (thus eliminating the opportunity costs of having more sheep than can be cared for, and the liquidity problems presented by saving in cows). Passbook accounts, limited withdrawal accounts, and low-maturity fixed deposit accounts can all be used in lieu of saving in animals—and savers can customize use of these accounts depending on their particular income streams. For savings goals such as children's education and

[7]Keeping grain and non-easily perishable cash crops at home are methods of saving with generally similar advantages and disadvantages to those of saving in cash (though there are some differences). Depending on the circumstances, MFIs can often draw some of these informal savings to passbook accounts, and sometimes to other accounts as well.

house renovation, both the limited withdrawal account and fixed deposit accounts with various maturities are useful, and can also be customized to household needs.

Returns from financial savings can be lower than returns from animal propagation and their by-products. But many rural savers say that the security and convenience offered by well-run MFIs, coupled with the decrease in time and resources spent in for caring for animals (and sometimes the use of that time to increase income), outweigh any higher returns that may be gained from using animals as a form of savings.

Gold, silver, jewelry, and other valuables. Precious objects are prized household possessions. They are generally in demand, useful as status symbols, and usually small and easily transportable. They are widely used for savings. But like other methods of informal savings, these too have both advantages and disadvantages. The advantages are obvious: precious metals, gems, and jewelry are generally in high demand, they are typically fairly liquid, and they can easily be pawned They can also serve as a hedge against inflation or currency devaluation, and may provide capital gains. And they can be used as collateral for loans. But many people say that beyond the jewelry they wear and valuable ceremonial objects they may own, they do not want to save in gold, jewelry, and the like because of the security risk. Such valuables must be hidden from outsiders who might steal them and from insiders who might appropriate them, claiming shared rights. And since gold and jewelry are usually sold at time of emergency, gold merchants may take advantage of poor people who need to sell valuables quickly.

Valuable objects of this kind are used for a wide range of savings purposes: emergencies, managing irregular incomes, social and religious obligations, medium- and long-term investments, and saving for disability and old age. A small set of well-designed and well-delivered savings instruments with different ratios of liquidity and returns can draw some (not all) of these savings to MFIs. In this case, the overwhelming advantage offered by the financial institution is security.

Box 1

Three Views from Savers

A conversation with two Indonesian farmers: Gold or sleep?

"If we have gold in the house we cannot sleep peacefully. In the old days there was always somebody at home. Now we are working and the children are in school. Sometimes we are all away from the house at the same time. How can we leave the gold behind?"
Robinson 2001, p. 239

A long road to a small sum of money in Uganda

"Old people are very trustworthy. A lot of young people used to keep their money with their grandparents. The sad thing is, most grandparents and grownups have died. So it is a problem. Now most people have to buy chickens, transform them into goats and then later to cows which they afterwards have to sell to have a lump sum of money."
A Ugandan vegetable farmer, quoted in Mutesasira and others, 1999, p. 9

An answer from Kenya to the frequently asked question by officers of financial institutions:

"If we offer savings accounts to low-income people, do you think they will they know how to use them?"

NR owns and runs a very small shop in Nairobi where she sells radios, radio parts, and occasionally a small television; the shop also repairs radios. When I met her, she was a borrower of the Kenya Rural Enterprise Programme (K-REP)—before it became a bank. As the NGO K-REP was preparing to transform to a bank, it began to learn about what would be involved in mobilizing voluntary savings when it was transformed to a bank. In this context, I talked with NR and explained three types of savings and deposit accounts that the new K-REP bank might offer when it was licensed. I described to her an interest-bearing savings account permitting an unlimited number of withdrawals, a savings account with a higher interest rate in which withdrawals were limited to two per month, and a fixed deposit account featuring the highest interest rate of the three products but including a penalty provision for withdrawal before maturity. I then asked if she would find any of these products useful. She replied immediately:

"I would want to have all three accounts for different purposes. The account that allows withdrawals at any time would be good for me because I can afford to buy only one radio part at a time. As soon as I sell the part, I buy another—so this type of account would be good for buying parts. I would use the account that allows withdrawals twice a month for my repair service. I have an employee who repairs radios, and I pay him every two weeks. I could deposit the money for his salary in that account, as I would need to withdraw from it only twice in a month. Also, I have to save to buy radios and television sets. I would use the fixed deposit account to save for these; the higher interest rate would help me to acquire inventory faster."

Robinson, 2001, p. 106-7

Special circumstances: an example

There is another important aspect to learning about what microfinance clients want from their financial institutions. In some circumstances, it is essential for an MFI to develop a detailed, in-depth knowledge of particular social, cultural, financial, and religious principles practiced by the people who live in the region it serves. Islamic banking is a good example. In areas with Muslim populations, MFIs seeking to learn about microfinance demand must learn whether Islamic banking methods are practiced—and if so, to what extent. Where Islamic banking is strictly practiced, MFIs will need to consider whether and how they can adapt their methods to its principles.

Under Islamic (Sharia) law, money is considered a medium of exchange without intrinsic value, and accordingly Islamic banking principles forbid the making of money with money. Since money is not considered an earning asset, gaining income through fixed interest payments (*riba*) is prohibited. But risk sharing and profit sharing between the owner of the capital and its user are encouraged. Thus when strictly observed, Islamic banking principles require adjustments to standard lending and savings products, as well as to other banking instruments. Loans may be provided, but on a profit-sharing basis. While a fixed interest may not be paid on savings accounts, financial institutions can invest clients' savings in industries that comply with Sharia law—and can then share the profits from these investments with the savers.

From the perspective of learning about, and meeting, the needs of Muslim microfinance clients, these principles can present challenges for MFIs. But learning what the challenges are is the first step. There are three main levels that must be distinguished. First, many Muslims do not practice any form of Islamic

banking, and for them no adjustments need to be made to the MFI's commercial microfinance practices. Second, in areas where Islamic banking exists but is not strictly practiced, MFIs sometimes develop certain accommodations acceptable to the clients, such as replacing interest on loans with service charges. Another such adjustment is providing a savings account in which depositors can earn income on their savings from a premium (*hiba*) paid at the discretion of the financial institution (which uses the savings to earn assets).

However in countries where Islamic banking is strictly practiced, MFIs that want to serve Muslim clients must make substantial adjustments to meet Islamic banking principles. Such accommodations "can affect the core of an institution's systems, operations, and beliefs" (Al-ZamZami and Grace 2002, p. 2). These authors present a case study of the wide range of operational and financial adaptations that had to be made by a microcredit program in Yemen to adjust standard MFI methods to relatively strict Islamic banking practices.

But there are also many common aspects of microfinance and Islamic banking, including types of loans and savings products, access by creditworthy borrowers to repeat loans of gradually increasing amounts, use of multiple banking outlets, employment of local staff, and others. MFIs that serve areas practicing Islamic banking at any level (as well as those operating in regions where other kinds of religious or social principles affect financial arrangements) must work closely with the local people to develop a common understanding of the issues. In the process, the MFIs will be learning what the clients there want. And if the MFIs can design products, pricing, and operations that are mutually acceptable to the institution and the clients (and in some cases also to the religious authorities or government), they will be in a good position to meet local demand.

When MFIs have learned what potential savings clients like and do not like about their present savings options, they can design products that preserve the former and, to a large extent, eliminate the latter. With careful thought and planning, this turns out to be possible to a greater extent than one might think.

However, from the viewpoint of the saver, financial savings also have a downside. Thus savers at MFIs perceive some disadvantages to saving in a financial institution, compared with saving in informal methods. These include transaction costs (travel expenses, and the opportunity cost of time spent in travel and waiting in line), possible taxes on interest income, and most important—the risk that the MFI may fail and savers may lose all or part of their savings. But these potential disadvantages are generally considered to be far outweighed by the much-in-demand package of products and services that well-run commercial MFIs can offer.

III. Ten Basic Principles for MFIs Mobilizing Savings from the Public

Underlying the performance of successful microfinance intermediaries that mobilize public savings are some basic principles. Ten of the most essential are discussed here. These principles are especially important for microcredit institutions transforming to regulated financial intermediaries, as such institutions tend to have little prior experience with either public savings or financial intermediation.

1. *Poor people in developing countries save. The job of the MFI is not to teach them to save, but to provide products and services appropriate for their needs.*

This is the first principle of mobilizing voluntary savings from low-income people. As this point was discussed in Part II, it is not considered here. But it is essential and therefore bears mention here.

> *Transforming MCIs, as well as MFIs, often ask me: "How can we train our clients to save?" My answer is: "Don't train the clients to save. Instead train your managers and staff—first to learn what the clients' demand is, and then to provide for it."*

2. *For credit, the MFI must trust the client. But for savings, it is the client who must trust the MFI.*

MFIs that mobilize voluntary savings from the public must be, and must be perceived as, trustworthy, secure, and stable. The full savings package that is demanded— security, convenience, liquidity, confidentiality, helpful and friendly service, returns, potential access to loans, and savings as a legally recognized asset—is a package that is not delivered in the informal sector—where savings may be secure, but without returns; or may provide returns, but not liquidity; or may be convenient, but risky. However, regulated MFIs that provide clients with this complete package can (and have) attained wide outreach.

But just being regulated is not enough. Clients who are borrowers will often travel long distances and wait on long lines for matters connected with their loans (unless the MFI operates in a competitive environment where better service is available). But savers will generally not accept substantial transaction costs, including the opportunity cost of their time, to make use of savings facilities. Convenience of location and opening hours; a choice of several appropriate savings products and services that can be customized for each saver's needs; and well-trained and helpful staff are essential to attract, and keep, savers. And when introducing savings products, public relations become important—because potential savers need to know about the institution and why they should put their trust in it.

Savers who come to MFIs may be poor and illiterate, but they are typically perceptive and rational. If they are not treated with respect and served efficiently, they will return to saving in animals or in gold or they will put their cash back under the bed or beneath the floor. Or if the opportunity exists, they will move their savings to another institution. They will tell their family, friends, and neighbors about their experiences with the MFI they left. And the word will spread.

MCIs accustomed to the idea that the institution selects its customers (borrowers) often find it difficult to make the adjustments in management, attitude, training, products, and services that are required when an MCI becomes a financial intermediary serving voluntary savers.

> *Transforming MCIs, and their newly created financial intermediaries, must ensure that this message—for savings, it is the client who selects the institution—is understood and internalized throughout the MFI, from the board members to the security guards.*

3. *Certain basic preconditions are needed for mobilizing voluntary savings from the public.*

MCIs with owners, board members, and managers who are interested in having their institution become regulated, and who understand and agree with these first two principles, must consider next the preconditions necessary for the successful operation of a financial intermediary with large numbers of low-income clients among its customers. Five main preconditions need to be met before a financial institution begins—and before it should be allowed to begin—the mobilization of public savings. The first three, however, are

usually beyond the control of the institution. But in some cases MCIs with powerful owners and boards have been able to work with the regulatory authorities to develop appropriate regulations and supervision for the transformed MFIs (points ii and iii below).

i. ***The political economy.*** Mobilizing voluntary public savings, especially at the early stages, requires at least a moderately enabling macroeconomy and some degree of political stability. Especially in difficult environments, careful judgment based on knowledge of the local political economy is important both for institutions applying for a license to collect and intermediate public savings and for their regulatory authorities. In this context it is also important to recognize that large-scale and competitive mobilization of voluntary public savings, including accounts held by many low-income savers, is unlikely to succeed in areas where donors or governments provide continuing subsidized credit and grant funds for microcredit. MCIs that are provided such low-cost funds on a long-term basis are also provided a negative incentive to undertake the work needed to meet demand for savings services.

ii. ***The policy and regulatory environment.*** The policy and regulatory environment. A reasonably adequate policy and regulatory environment is needed—or if not immediately possible, at least a consistent non-enforcement of inappropriate policies and regulations. MFIs that are licensed to take savings from the public and to intermediate these funds need to operate in an environment characterized by liberalized interest rates and appropriate regulations. The latter include appropriate specifications for minimum capital requirements, capital adequacy ratios, liquidity ratios, accounting and audit standards, criteria for opening branches, reporting requirements, and the like.

iii. ***Public supervision.*** For the protection of their customers, especially savers, MFIs that mobilize voluntary savings must be publicly supervised. This generally means that their governments must be willing to modify their standard banking supervision practices so that the rules for microfinance institutions are suitable for their activities. As in the case of regulations, appropriate supervision does not mean relaxing standards. It means applying high standards in ways that are relevant for MFIs. It also means ensuring that the supervisory body has, or develops in a timely manner, the capacity to monitor effectively the performance of such licensed microfinance providers.

iv. ***A strong institutional performance record.*** An MCI planning to transform to a regulated financial intermediary must have a strong performance record and an excellent reputation. It must have (or be prepared to add) high quality ownership, governance, and management capacity that is appropriate for a financial intermediary (discussed in Part IV below). The institution should have demonstrated a track record of high-level performance and transparency. It should have effective and efficient operations, maintain a high rate of loan recovery, and regularly earn good returns. It should be financially self-sufficient, with considerable outreach. And it must have a corporate culture that is open to new ideas, new products, and new methods. MCIs that do not meet these criteria should not be licensed to take public savings.

v. ***The institution must be prepared to make basic and far-reaching changes, many of them in a relatively short period.*** The MCI's owners, governing board, managers, and staff, as well as the licensing authorities, need to understand that the MCI—but not its mission—will change fundamentally when it becomes a regulated MFI and undertakes voluntary savings mobilization. As discussed below, these changes affect the institution's organization, leadership, infrastructure, information, and most of its operations. An institution that is not prepared for fundamental changes should not proceed further in planning for collecting public savings.

Efforts to mobilize public savings should begin only when all five preconditions have been met, although judgment calls may be needed concerning the state of the economy and the political context. And some leeway may be required for certain issues of regulation and supervision. In many countries commercial microfinance institutions and the regulation and supervision of microfinance are evolving simultaneously.

4. Owners, board members, and managers of regulated MFIs must meet legal requirements for responsibility and qualifications

One of the most important principles of the commercial microfinance industry is that owners, board members, and managers must be certified, using international standards, as "fit and proper"—and that they must be accountable for their decisions and their conduct. Owners of regulated financial institutions that serve microfinance clients are legally responsible for their actions and for their institution. Board members must be competent to oversee a rapidly growing financial intermediary. And managers have to be well qualified—that is, experienced, financially skilled, and knowledgeable about the microfinance market. Thus the transformation of an MCI to a regulated intermediary is not confined to the institution's legal and regulatory status and the financial services it provides. Ownership, governance and management are essential to the transformation process. But when MCIs become regulated, they often face special problems in this regard.

For example, unregulated NGOs providing microcredit frequently do not have clear, accountable ownership. Yet regulated financial intermediaries are (or should be) required to have qualified and accountable owners. This is often not an easy transition, and changes in ownership can be prolonged and difficult.[8]

A related problem concerns the governance of the newly-regulated institutions. MFIs created by NGOs sometimes appoint members of the NGOs' boards to sit on the boards of the regulated deposit-taking institutions. Such appointees may be people with considerable dedication and longstanding commitment to helping the poor and advancing microcredit. But their backgrounds are often in the social services or other non-financial professions, and they are frequently not competent to oversee complex financial intermediaries serving a wide range of clients. Establishing appropriate governance can be challenging, and the problems may be exacerbated by conflicts of interest.

Also, managers and staff of the parent NGO may be appointed to the new institution in positions for which they are unqualified. Managers of excellent NGOs, even those who initiated their institution's transformation process, are often not the right choices to manage the financial intermediaries that emerge from the transition. The skill sets required are different in many respects. Relatively few MCI managers have the financial skills and managerial experience needed to take responsibility for a fast-growing, regulated financial intermediary.[9]

When an MCI transforms to a regulated MFI and begins to mobilize voluntary savings from the public, the institution is adding to its operations not only savings, but also financial intermediation. Often little attention is given to the latter during the transformation process. But together, these two activities typically require significant increase in the financial expertise of the newly regulated institution. However, finding experienced management with strong financial skills, coupled with knowledge of the opportunities and risks of the microfinance market, can be very difficult. Well-qualified managers for microfinance intermediaries

[8]The ownership issue can also be exacerbated by disagreements between donors or international NGOs that have established MCIs planning to transform to regulated MFIs, and the country's regulatory authorities. The former may insist on maintaining 100 percent, or at least majority, ownership while the latter require a more diversified ownership.

[9]This problem is, of course, not unique to microfinance. That people who are successful in envisioning and building institutions are often not qualified to manage these institutions once they have become large and complex is a fact well known to the business world.

are scarce and generally expensive. They need to be actively sought, and their services suitably budgeted. And careful oversight by a competent, well-structured board is essential.

The overall management problem in the global microfinance industry at present is the result of a small pool of well-qualified MFI managers, combined with a rapidly increasing demand by regulated (or about-to-be-regulated) MFIs for financially skilled managers with appropriate administrative experience. Some much-needed efforts are being made by a variety of institutions to train managers for microfinance—and also to attract experienced financial managers into microfinance— but there is a long way to go.

Meanwhile what happens too often is that well-meaning, but unqualified, managers are transferred to the MFI from the parent NGO. Such managers often fear the changes that come with regulation. They may fear losing their mission. They may also fear losing control of the institution (and their jobs) to outsiders.

Thorny problems, and sometimes acrimonious disputes, can arise when difficult questions emerge during the transition from MCI to MFI. Can appropriate owners for the new institution be found who are commercially oriented, but are also "patient investors"? Who should be appointed to the new board? Who is to manage the new MFI? Which NGO staff are to be appointed to the regulated institution, and which are to remain at the parent NGO (if it continues)? Are there managers and staff who should be phased out or retired? What are the criteria to be used? What positions should be filled from outside? Such issues can result in instabilities and conflicts that increase already-existing tensions and factional disputes—which in turn can lead to operational crises, just as public savings services are being introduced.

In some cases, an independent outside review of the MFI can be helpful. Usually some of the MCI's methods can be adapted to the new circumstances, and some managers and staff can be retrained. Others cannot. What is needed is "the wisdom to know the difference"—and the leadership to make the necessary changes.

> *Nothing is gained by postponing crucial decisions about ownership, governance, and management. Regulated MFIs created by MCIs must have qualified owners. Their board members and managers must be competent, respectively, to oversee and to operate financial intermediaries. It is especially important that the authorities responsible for licensing deposit-taking MFIs perform careful due diligence in this regard.*

The next two principles (5 and 6) focus on fundamental changes that must take place when microcredit organizations transform to regulated deposit-taking intermediaries. The transitions and reorganizations discussed below need to be planned and started long before the institution begins collecting voluntary savings. For a transforming MCI, change is not an option, it is a prerequisite.

5. Regulated commercial MFIs must mobilize savings from the public, and not from the poor alone.

This sounds obvious, and it is.[10] But few MCIs understand what this would mean for their organizations if they became financial intermediaries. Can financial institutions that want to be financially self-sufficient, and that plan to fund their microcredit portfolio substantially or entirely from savings, mobilize voluntary savings from the poor on a large scale and remain profitable? Not if they confine their savings services to poor savers. The transaction costs are too high to collect savings only in very large numbers of small accounts. It is possible that with the increasing development of technology, the costs of servicing small accounts may decrease in the future. But typically transaction costs for a $5 savings account are little different from

[10]The discussion in points 5 and 6 is adapted from Robinson 2002b.

those of a $1,000 account. For this and other reasons discussed below, commercial MFIs should not collect savings only from poor people. Serving large numbers of small savers can be labor intensive and therefore costly (even if no interest is paid below a certain minimum balance).

When MFIs mobilize voluntary savings from large numbers of poor people, they need to raise the average account size with larger accounts. Such MFIs can then mobilize savings profitably and on a large scale, and they can afford to meet demand from low-income savers with small accounts.

But MFIs that have transformed from MCIs typically carry considerable baggage. This can be in the form of objectives, products, practices, training, attitudes, and others. All of these may have been crucial for the success of the MCI, and some remain essential for the new MFI as well. But others must be changed, as some MCI assumptions and practices can be counterproductive for a regulated financial intermediary. For example when MCIs transform, they often continue defining their target market as poor people, mainly women. And they often refuse—sometimes through policy, and sometimes in practice—to serve other kinds of clients. For reasons discussed below, this approach does not work for regulated financial intermediaries.

Successful commercial institutions that provide financial services to many poor clients also collect savings from middle- and even high-income individuals, as well as from organizations, businesses, and institutions that are located near the MFI's branch or sub-branch. This permits the MFI to meet local demand for savings services, to collect small savings from the poor, to use savings from all sources to finance an expanding microloan portfolio, and to maintain the institution's financial self-sufficiency.

Mobilizing savings from the general public has another important advantage: staggering withdrawals. If MFIs target only low-income clients, withdrawals can be clustered around certain times—when school fees are due, at religious holidays, in pre-harvest months, and the like. If a large number of clients withdraw savings at the same time, the institution can face a liquidity crisis. But when savings are collected from a range of clients, including organizations and institutions, this problem is unlikely to occur except in special circumstances such as hyperinflation, regional shock, or loss of trust in the MFI.

There are, however, high transition risks to this approach. Does the transforming institution know how to design and deliver products, including loans, for a wider variety of clients than it has previously served?

For example:

- Do staff members know how to approach and talk with new kinds of clients?
- In the case of institutions that have previously served only poor groups of women, can the staff explain its products and services clearly to men who may be potential clients? To middle-income people? To organizations, institutions, and businesses operating in its service areas?
- Savers who are not poor tend to demand individual loans (as also do many low-income savers). A potential client who wants to save $1,000 and also to borrow is not likely to agree to join a solidarity group to obtain the maximum $100 loan available to new borrowers. Under such circumstances, the potential client is quite likely to take his savings elsewhere (even back home). Before opening its facilities for public savings, the newly regulated institution needs to design individual loan products, and must also make sure that its staff has been well trained and carefully tested in assessing the creditworthiness of individual borrowers and their enterprises. Such an institution should ask itself: Do our loan officers really know how to evaluate the creditworthiness of individual loan applicants? Do they know how to collect individual loans? Do our managers understand that some of the institution's traditional group loan customers may, for good reasons, prefer individual loans once these are offered? Is there a plan for allowing such shifts, and has the potential cost been analyzed?

- Have staff at regional and branch offices understood and internalized the institutional changes required to mobilize public savings effectively, and are they implementing these in practice? This often takes considerable time.

MFIs that succeed as intermediaries are those that understand that they can provide much-in-demand financial services to far larger numbers of poor people than they did previously—if they also serve other kinds of clients. They know the reasons for these questions, and they work hard to answer them positively. It is also important that regulatory authorities fully understand this issue, as it affects both regulation and supervision. For example, deposit insurance regulations sometimes make a distinction between MFIs and other financial intermediaries, setting a ceiling for deposit insurance that is too low for MFIs that want to attract larger savers. That can create a problem with far reaching consequences because MFIs serving poor voluntary savers need the accounts of larger savers.

In their role as credit providers, some institutions specialize in microcredit while others serve a wide range of borrowers, including low- and lower-middle-income clients. But the options for savings mobilization are different. Regulated commercial microfinance institutions that want to meet local savings demand and fund their microcredit portfolios with voluntary savings must serve a wide cross-section of savers. Commercial microfinance thus refers to profitable financial intermediation between borrowers with loans up to a cutoff point set by the institution (which can vary widely) and all locally available savers.

6. *The numbers of borrowers can be controlled by the numbers of loans approved, but voluntary savers cannot be turned away without widespread and long-term negative effects. This fundamental difference can result in rapid, and largely uncontrollable, growth in the client base when a newly-regulated MFI opens savings facilities to the public.*

There are, in aggregate, significantly more savings accounts than outstanding loans in financial institutions that offer voluntary savings services suitable for low-and lower-middle income people. Many such institutions also often have higher volumes of savings than of outstanding loans.

A recent study by the Consultative Group to Assist the Poor (CGAP) on loans and savings accounts in more than 3,000 “alternative financial institutions” (AFIs)—institutions that focus on clients who are at an income level generally below that of commercial bank clients—found that “on an aggregate basis, savings accounts in AFIs outnumber loans by about four to one”. This is a worldwide pattern that does not vary much by region” (Christen, Rosenberg, and Jayadeva 2004, p. 7). The study found more than 152 million active loans (disbursed but not repaid or written off) and more than 573 million savings accounts in the AFIs covered. These totals include loans and savings accounts in MFIs; cooperatives and credit unions; and in rural, state, agricultural, development, and postal banks.[11] While the income levels of the clients holding these savings accounts and loans in AFIs are not available, “it is clear that AFIs, including those not usually thought of as microfinance providers, serve a very large number of poor or very poor clients” (p. 5). There is no doubt that savings accounts in financial institutions are in high demand by low- and lower-middle-income people in developing countries around the world.[12]

[11]The terminology used in the CGAP study differs somewhat from that used here. In this paper MFI is used, for convenience, to refer to all types of microfinance providers, both those that specialize in microfinance and those that serve a wider range of clients. In contrast, the CGAP paper uses MFI in a restricted sense to mean institutions that specialize in microfinance, while AFI is used there to refer to the broad category of institutions (including MFIs) that focus on clients generally below the level served by commercial banks. Both the term MFI as used in this paper and the term AFI as used in the CGAP study include institutions such as financial cooperatives and credit unions, rural and agricultural banks, postal savings banks, and others.

[12]See also Robinson 2001, 2002a; MicroSave-Africa 2000, 2001d; Mutesasira 2000; Rutherford 2000a; and Wright 1999c.

Thus when an MFI that has been transformed from an MCI first offers well-designed and effectively delivered voluntary savings products and services to the public—especially in areas with substantial unmet demand—the institution may quickly find itself with large numbers of new savers.

This is the second crucial reason that basic institutional change occurs in transformed institutions. MCIs can control the number of their clients because they are borrowers, and it is the MCI that determines how many loans it gives. But regulated intermediaries cannot limit the number of their savers, except by driving them away—which would create severe long-term problems for the MFI, and also defeat its mission. Thus rapid client growth is likely to occur after the MFI makes voluntary savings services available to the public. But such large and essentially uncontrollable growth carries substantial financial, operational, and strategic risks.

Managing this growth requires highly skilled—also scarce and costly—management resources. When an MFI opens its doors to public savings, it must have the capacity to provide the services the clients have been promised. This typically requires additional, and considerably upgraded, management, staff, internal supervision, training, transportation facilities, security, space, furniture, supplies, and the like. Treasury management, asset-liability management, and liquidity management become crucial. And the information management and reporting systems must have the capacity to handle the increased complexity of the MFI's operations.

The most critical problem here is that, as noted, even an excellent manager of an MCI is not necessarily an acceptable manager of the transformed institution when it becomes a financial intermediary. In an institution that opens voluntary savings facilities for the public, or is planning to do so, the problem of mismatches between skills and responsibilities can come to a head quickly. And inherent conflicts of interest among the players can make such issues exceptionally difficult to resolve. These matters should be settled before the institution is licensed as a deposit-taking MFI. But for various reasons, including inertia, incompetence, and political influence, this does not always happen.

There is considerable evidence, though, that rapid growth in savings has been achieved by leading MFIs of various types. To give an idea of possible growth curves, Box 2 provides examples of rapid growth in different kinds of institutions. Not coincidentally, all have excellent management and all are financially self-sufficient. Their rapid growth in savings (along with simultaneous growth in lending and fundamental changes in the organizations) made enormous demands on the high-quality management of these institutions. Extraordinary management skills and commitment were a sine qua non for the performance record of each of these institutions. Even then it was difficult. But though each still faces challenges (of different kinds), all these institutions are now industry leaders.

Once again there are critical questions that need to be asked—by both the transforming MCI and its country's supervisory authorities—well before the institution is licensed to collect and intermediate public savings.

- Can the institution manage and finance such rapid—and largely uncontrollable—growth in savings?
- Can the MFI coordinate and manage the different types of organizational, operational, and attitudinal changes that are required for a financial intermediary?
- Can it manage the many changes in operating procedures that must be instituted and maintained?
- Can it maintain a high-quality loan portfolio while investing the resources needed to introduce and intermediate voluntary savings from the public?

These are not hypothetical questions. Institutions that do not prepare adequately to meet these challenges and risks can find themselves in considerable difficulty. The financial risks include liquidity and portfolio risks. An example of the latter is a newly-regulated MFI that makes serious mistakes in introducing public savings facilities in its institution. This problem usually occurs because the manager or the board, not adequately understanding the risks, rushes the process. Then multiple problems have to be rectified over a prolonged period. And this can then result in an overload on managers and staff—and, as it has in some institutions, in a rapid decline in loan portfolio quality. This, in turn, may then take substantial amounts of time and resources to overcome. The lesson here cannot be overemphasized: Do not rush the sequencing!

Operational risks include human resources risk (managers and staff who are poorly trained and insufficiently motivated to undertake their new responsibilities), information and technology risk, and fraud risk. Strategic risks, generally the most serious for newly transformed institutions, cluster around risks of governance, management, and reputation.

Voluntary savings mobilization from the public is not a matter of adding a few products to an MCI. If successful, it inevitably and irreversibly changes the institution, though not its mission. MCIs that are not prepared for such changes should not undertake to collect savings from the public. But those that are willing and able to make the changes needed to overcome the risks can profitably attain wide outreach as financial intermediaries and can serve as models of the industry for other institutions.

Box 2

Examples of rapid growth in voluntary savings by different types of microfinance providers

The Bank Rakyat Indonesia (BRI)

In 1983 the microbanking system of the then-failing, state-owned Bank Rakyat Indonesia (BRI) had $18 million in savings after a decade of offering voluntary savings services in more than 3,600 bank units located in all the country's sub-districts (the number of accounts is not known). With interest on loans set by the government at 12 percent and interest on savings at 15 percent per annum (and other major mistakes), this was a savings program that could only fail. In addition, loan defaults were high and losses large. But in 1984 BRI's loss-making, heavily subsidized microfinance program was converted to a commercial microbanking system. As part of the reforms, BRI totally revamped its approach to voluntary savings and began pilot projects in a major new microbanking savings initiative. Ten years later, by the end of 1993, the microbanking system had $2 billion in 11 million accounts (compared to the $18 million collected during the previous decade), and by 1996 the microbanking system had $3 billion in 16 million accounts. And the number of savings accounts and the rupiah value of savings continued to increase substantially throughout the severe Asian financial and economic crisis of the late 1990s (see Robinson 2002a, chapters 11,13, 15). As of 2003, BRI's microbanking system had $3.3 billion in 30 million savings accounts.

Equity Building Society (EBS)

In 1994 Equity Building Society (EBS) in Kenya began its conversion from a failed mortgage lender to a commercial microfinance institution. EBS had mobilized voluntary savings between 1984 and 1993, but the institution had a narrow product focus and its managers and staff knew little about client demand. Savings stagnated. Then a new management team took over and began to revise its products and services, with the result that savings grew from $3 million in 12,000 accounts in 1994 to $7 million in 41,000 accounts in 1998. By 1999 EBS was ready to begin full-scale, client-focused savings mobilization methods—learning about customer needs and designing and delivering products tailored to client demand.[13] And by 2003 EBS savings had jumped from its1998 totals of $7 million in 41,000 accounts to $43 million in 252,000 savings accounts—a growth in 5 years of more than 6 times in both the number of accounts and the value of savings. The year 2003 alone saw a growth of $22 million (a one-year increase of 65 percent) in more than 100,000 new accounts (an increase of 63 percent).

Two Bolivian nonbank financial institutions

Two Bolivian NGOs that transformed to regulated nonbank financial institutions (partly in order to be permitted to mobilize voluntary deposits), show similar trends: Fondo Financiero Privado para el Fomento a Inciativas Económicas (FIE) and Caja Los Andes. In 1998 FIE had $8 million in 121 voluntary savings accounts. By 2002 it had more than doubled the value of its savings to $18 million and had 7,277 accounts (60 times the 1998 total). And Caja Los Andes, which had $3 million in savings in 1996 (the number of accounts is not available), had increased its savings by nearly 8 times to $23 million in 23,308 voluntary savings accounts in 2001.

Source: Bank Rakyat Indonesia, Equity Building Society, and the Microfinance Information eXchange (MIX).

7. Savings is not only a service and a source of funds, it is a liability.

MFIs need to pay careful attention to protecting savers' funds from risks that include internal corruption, theft, loan defaults, investment losses, and others. There is sometimes a tendency to concentrate on one or another of these, but not sufficiently on all. All MFIs are vulnerable to all of these dangers, and continual vigilance cannot be overemphasized.

- *Internal fraud.* A culture of accountability is required of MFIs for many reasons, but it is especially important for deposit-taking institutions and financial intermediaries. Internal corruption is, of course, a potential problem for the MFI and a risk for savers. Strong effective management, a clear policy of delegating responsibility and holding managers and staff accountable for their decisions and actions, appropriate MIS, careful internal supervision and controls, and a promotion and incentive system designed to encourage employee loyalty to the MFI can all help to prevent internal fraud.
- *Security measures.* Additional and improved security measures are needed when an MFI begins collecting public savings (safes, guards, methods for transporting cash, and the like).
- *Loan defaults.* Nonperforming loans can also put savers' money at risk. As noted, it is crucial for an MFI introducing voluntary savings products and services to maintain high loan portfolio quality. Before introducing public savings, transformed MFIs must have effective procedures in place for loan collection; accurate, transparent accounting and reporting systems; and qualified, well-managed internal supervision and audit.

[13]MicroSave-Africa, a large program funded then by the United Kingdom's Department for International Development (DFID) and the Consultative Group to Assist the Poor (CGAP), was instrumental in helping EBS to learn how to understand their clients' needs and to design appropriate products and services for the microfinance market.

- *Losses from investments.* Recently-transformed MCIs are generally not well-experienced in investing excess liquidity generated by public savings. Such investment requires significantly more attention and expertise than is often given to this significant risk for new (and some old) MFIs.
- *Budgeting for new operating costs.* Common problems in transforming MCIs include a propensity to plan separately for savings and loans, and sometimes also a refusal to consider changing their traditional loan terms, procedures, and interest rates. A related problem is inefficiency. Financial intermediaries must set (and adjust as necessary) the spread between interest rates on loans and savings so that it is sufficient for profitability. This includes having a spread that is adequate to cover the expenses that keep savers' money safe. New cost issues may require changes in the institutions' traditional loan products, as well as improvements in its efficiency.

A successful intermediary focuses on all the risks pertaining to its liabilities—and it allocates sufficient funds and human resources to do this effectively. It designs, prices, and manages its savings and lending products together.

8. New kinds of products and services, a wider range of clients, and larger-scale operations require a major effort to develop new training and incentive programs for management and staff.

The market served by commercial microfinance intermediaries—low- and lower-middle-income borrowers (men and women), and savers from all income levels—is a quite different market from that served by most MCIs, though there is overlap. The management and staff of transformed institutions need to learn how to serve a wide range of clients profitably. It is rarely appreciated at the start how much retraining of personnel is needed for this change to be made effectively.

- Most transformed MFIs beginning public savings mobilization have considerable experience with the microcredit market but, as noted, they usually have little knowledge of collecting or intermediating voluntary savings. Thus managers and staff need to be trained in developing savings products and services appropriate for all types of savers. And they need training in how to identify, talk with, and mobilize savings from larger savers. They usually also need to be trained in evaluating loan applicants for individual loans, and in how to collect the loans. Not all regional and branch managers and staff can carry out these new activities effectively, even after training. Some managers may have to be retired, transferred to a different type of job, or phased out of the institution.
- Training in multiple new concepts and activities is needed to ensure that the managers and staff of a transforming MFI are capable of designing and delivering appropriate products—and of reporting and remedying any important design flaws that may be discovered in the course of product delivery. Both classroom and on-the-job training are needed in market research, product costing and pricing, and in developing and implementing new operational procedures and manuals. The training must also focus on changes in internal communications, backroom operations, and management information services; on accounting, reporting and audit systems; and on internal controls, as well as on instituting and operating new security measures. And training must include rigorous procedures, including client feedback, for monitoring and evaluating performance results.
- Because so much that has to be learned is unfamiliar to newly-transformed MFIs, those beginning public savings must make a special effort to find trainers of trainers with the right kinds of backgrounds and skills, and they must then develop their own in-house trainers. Their previous trainers are often not competent (and sometimes unwilling) to train staff in savings mobilization, financial intermediation, and individual credit products. Some can learn, but finding suitable trainers can be difficult.

- Attractive incentives for management and staff are essential. For regional and branch offices, these should be provided to employees based on the performance of each branch, sub-branch, or other lowest-level unit that delivers financial services. Incentives should be provided both in cash and in institutional recognition at each lowest level unit that meets its goals. There are many kinds of incentive schemes used by MFIs (see Holtmann 2003). Some may work better in some regions and cultures than others. One that has worked extremely well for nearly 20 years in a very large institution is the incentive system developed by Indonesia's BRI (see Robinson 2002a, chapter 14). There the cash incentive payment, a percentage of the unit's profits, is divided among all managers and staff who work at a particular unit, in proportion to their salaries. In addition, everyone who receives an incentive bonus is formally recognized at a ceremony presided over by BRI's highest-level managers. The incentives are based on the overall performance of each unit, with various weightings given to increases in the numbers of loans and savings accounts, growth in amounts of savings and outstanding loan portfolio, the quality of the portfolio, and the administrative performance of the managers and staff. Unit supervisors at branch level are also given incentives when the units for which they are responsible meet their goals. Further incentives are provided to units that are best in their region and those that are best in the country (and to their branch supervisors).

Newly-regulated institutions that want to mobilize public savings need to learn how to serve a wide range of clients profitably, and how to give (and collect) individual loans. New kinds of training are essential, as are an attractive performance-based incentive system. But incentives should not be based on savings performance alone, as portfolio quality (and other activities) may then deteriorate.

9. *MFIs starting to collect savings from the public should offer a few well-designed savings products and, if they do not already have one, a general-purpose individual loan product. The increasingly common view—that a wide choice of products is important—should be avoided.*

When beginning the mobilization of public savings, MFIs should offer a few carefully designed savings products—so that savers of all types can customize their use of these products to meet their own needs. And if the institution does not provide individual loans, these should be added. As noted, the products should be designed and priced together to enable both appropriate coverage and institutional profitability.
A savings account permitting unlimited transactions, a fixed deposit account (including some featuring relatively short maturities), one or two other savings products, and facilities for remittances and transferring funds are sufficient in the early stages. These basic products must be carefully designed for use in different combinations for different purposes by all types of savers—poor and nonpoor, individuals and institutions (see Part IV).

- Too many savings products make sub-branch and branch management too complex and expensive, and many products are not necessary for most savers. What is needed are a few complementary products, each of which is in high demand. Savers then customize their use of these products to meet their own needs—and they can reconfigure the ways in which these accounts are used as the savers' needs change over time.
- For many years, product design was neglected in microfinance. Now the pendulum has swung, and product design is too often overemphasized by MFI managers who sometimes appear to think that the race is won by the MFI with the largest number of products. Well-designed savings products are essential. But they are only one element in a much larger set of requirements for successful mobilization of savings from the public—many of which tend to be overlooked as increasing emphasis has been placed on designing multiple products. Product delivery is far more difficult than product design. Convenience of sub-branch location and opening hours, attitudes of managers and

staff toward clients, MIS, space use, asset-liability and cash management, efficiency of operations (e.g., short waiting periods for savers who want to deposit or withdraw, and an effective service for remittances), quality of administration, quality of the loan portfolio, trustworthiness of the institution, and many other factors are crucial to capturing and maintaining public savings. Getting the structure of these interlinkages right—which requires experienced, skilled management at all levels—is far more important than a wide range of products. The race is generally won by the MFI that demonstrates the best delivery of a few well-chosen products.

- As discussed, the newly regulated institution also needs to offer individual loans, which will be in demand by some savers—and the MFI must be prepared for the fact that some of its group borrowers will want to move to individual loans.
- Once the savings program is well established and the transformed institution has learned to make and collect individual loans, other products can be added. If not already offered, remittances and money transfers should be added, as these are particularly important for the microfinance market. Special fixed deposit accounts for education, retirement, housing, and ceremonies and pilgrimages are popular, as are housing loans. Insurance products are also often in high demand, but these are generally best offered through linkages with appropriate insurance companies rather than by MFIs directly.

The key to large-scale savings mobilization from the public is a few well-designed and effectively delivered products that clients can use to customize their savings portfolios in ways that meet their particular needs. It is unnecessary for the MFI to offer many products. It is also difficult and costly for the institution to manage effective delivery of more than a few products, especially in the beginning. Too many products can lead to strains on management and staff capacity that negatively affect both the MFI's performance and its client service. What is essential is consistent, high-quality delivery of a few complementary products in high demand.

10. Mobilizing savings from the public takes considerable time and proper sequencing. It should not be rushed to finance expanding portfolio requirements or for other reasons.

Most transforming MCIs have little understanding of how to sequence the introduction of mobilizing savings from the public. Yet this is a critical point, to which considerably more attention needs to be paid. This basic principle is explored in Part IV below.

Developing savings facilities for the public, including large numbers of poor savers, takes considerable human and financial resources, adequate time, and appropriate sequencing. Until the transformed MFI is ready to mobilize public savings, it should finance expansion of its loan portfolio through commercial debt. During the period in which public savings is being planned and introduced, the loan portfolio should not undergo major expansion.

IV. Sequencing the Introduction of Public Savings in Regulated MFIs

When an MCI considering transforming to an MFI has considered the requirements for mobilizing public savings and has decided that it is ready to learn to do this, the next step is to study the experiences of leading local and international MFIs experienced in collecting and intermediating public savings. A transforming MCI or newly-regulated MFI must understand the prerequisites for effective savings mobilization and examine carefully its own qualifications. It will then be time to decide whether the institution is ready to make the commitment to implement savings facilities for the public.

If the decision is positive, the MFI should conduct research both on the demand for savings products and on the market and the likely competitors. The transforming MFI will need to design and price products and delivery systems to be tested in at least one, and usually two, pilot projects—with the second based on the results of the first. The MFI's new products and services will then be revised and gradually expanded to all branches. Continuing monitoring of competition is advisable as the nature of the competition, and sometimes the competitors themselves, can change quickly in response to new entrants to the market.

The first-stage pilot project is essential for four main reasons.

- To determine whether the products that have been designed are in demand, and whether they can be efficiently and effectively delivered by the pilot branch.
- To analyze and revise the pricing structure, as necessary. Only provisional interest rates can be set until the extent of the demand for, and the costs of, different products are known. Pilots projects are required to ensure that products and services are priced correctly before they are rolled out to all branches, that operating costs are understood, and that spreads enable profitability. The information needed for costing and pricing must be collected, carefully analyzed, and incorporated into product design and pricing—before the institution attracts large amounts of savings.
- To test information, communication, security systems, and space requirements.
- To train managers and staff and to test a performance-based incentive scheme suitable for a financial intermediary.

Except in small institutions with few branches, a second-stage pilot—conducted in several different kinds of branches—is also usually required. The second pilot also has multiple purposes:

- To revise products, pricing, and operational changes, as needed; to revise and add training; and to make any necessary management and staff changes at the head office and at the pilot branch offices.
- To test the revised savings products in a number of locations and varied environments. The branches selected should represent a range of economic, geographic, demographic and agricultural conditions. They should include both urban and rural environments, and some branches should be chosen in areas where there is substantial competition. The second pilot also tests the ability of the head office to coordinate the introduction of savings mobilization simultaneously in different areas.
- To introduce (or if relevant, expand) individual loans.
- To phase out compulsory savings—where possible, convincing clients to transfer their mandatory savings to one or more of the MFI's new savings products.

It is usually too difficult to undertake these last two changes in the first pilot, but they need to be included in the second pilot so that the MFI has had experience with both when it begins financial intermediation in all its branches.

The second pilot should be followed by a gradual rollout to all branches. The next step then involves developing a systematic approach to savings mobilization so that in each service area, deep market penetration can be achieved. The final step is learning how best to invest excess liquidity safely.

This method is shown as a sequence of 20 steps in Box 3. This series of steps may seem time-consuming and cumbersome. But these varied stages of development are necessary to establish a solid foundation for the savings program—which will help greatly in preventing mistakes that can be extremely costly to the institution later on. Circumstances will vary somewhat among different institutions, and some will have already completed, in full or in part, some of the steps before becoming regulated. The sequencing can

be somewhat flexible, depending on particular circumstances. But a transforming MFI that does not follow appropriate sequencing in introducing savings for the public is taking a large and unnecessary risk. The motto here is “Haste makes waste!”

As discussed earlier, what savers want is a package consisting of security, convenience, liquidity, good service, confidentiality, returns, and access to loans—and they want their savings accounts to be legally recognized assets. It should be kept in mind throughout that it takes time to develop the capacity to design and deliver this package. But it is this package that brings large numbers of savers to MFIs—and that maintains the high and relatively stable savings balances needed for large-scale commercial financial intermediation.

The sequencing discussed below should be adapted by each MFI to its current stage of development. But newly-regulated MFIs should be careful not to skip steps they need. Most of them will need most of steps described here.

1. Learn international best practices for mobilizing savings

The institution’s owners and managers should start by learning about international best practices in microfinance—and specifically about microfinance institutions that mobilize large-scale voluntary savings from the public. Lessons can be learned from both the successes and the mistakes of other institutions, and examples exist in most regions.

Internationally there is much to be learned about savings from Indonesia, a country with a long history of financially self-sufficient regulated financial institutions mobilizing large amounts of voluntary savings from the public (see Steinwand 2001 and Robinson 2002a). Indonesia’s BRI and Thailand’s Bank for Agriculture and Agriculture Cooperatives (BAAC) are good places to visit to gain an understanding of large-scale market penetration in savings mobilization, much of it in rural areas. Bolivia is also a good choice because of its multiple recent transformations from NGOs to regulated nonbank financial institutions and banks. One of the main reasons for becoming regulated was to access deposits and commercial debt. And Bolivian MFIs are currently engaged in intense competition for microfinance clients. Visitors can see first-hand the recent growth of savings in the newly-regulated MFIs and learn the problems of transition (see Rhyne 2001, and Drake and Rhyne, eds. 2002). A visit to Peru’s MiBanco, a bank transformed from an NGO, would also be useful for MCIs considering transformation to a regulated intermediary. In Africa, Uganda’s Centenary Rural Development Bank, Kenya’s Equity Building Society, and South Africa’s Teba Bank are well worth a visit. Many of these are not transformed MCIs, but much can be learned from them by MFIs interested in mobilizing and intermediating public savings.

> ***Watch out for:*** *Misinformation! A great deal of information about microfinance is now available—and it is of widely varying quality. Less information is available about savings in MFIs than about credit, but the data sources for both span a broad range in quality. Institutions should ensure that when their board members and managers visit MFIs, they visit the best microfinance intermediaries. Managers and staff who attend training programs need to compare options carefully and select the programs best for their needs. And managers must check carefully that outside trainers who are brought to the MFI to conduct training on savings mobilization and financial intermediation are well experienced in savings and commercial microfinance intermediation. As an old Sanskrit saying has it,“You get the guru you deserve.”*

Box 3

Sequencing the Introduction of Voluntary Public Savings in Regulated MFIs

1. Learn international best practices for mobilizing public savings
2. Review the country's political economy, regulatory environment, and supervisory capacity for regulated MFIs
3. Review the history, capability, and performance of the MFI
4. Assess internal capabilities, identify gaps, recruit new staff as required, and retain outside experts as necessary
5. Conduct research on demand among potential savers of different kinds, and on the supply of savings facilities among competitors
6. Design and price products and services for the pilot project
7. Create a checklist: Is the necessary institutional capacity in place to open voluntary savings facilities to the public?
8. Develop criteria for a pilot project site and select the pilot branch
9. Prepare for the first pilot project—a complex and multi-faceted task
10. Conduct the first pilot project, ensuring that adequate resources are available (and used) for close supervision and regular, careful monitoring
11. Assess pilot results and revise products, pricing, operations, MIS, etc. as necessary. If a second pilot is needed (very likely), prepare the revisions and manuals for the second pilot
12. Plan the second pilot, selecting branches located in different environments
13. Train managers and staff of the second-stage pilot branches
14. Implement and evaluate the second pilot
15. Train senior managers and trainers for the rollout phase
16. Expand gradually to all branches, training managers and staff in each location. Do not rush this step!
17. To penetrate the market, develop a detailed, systematic approach to identifying potential savers and mobilizing their savings
18. Select a pilot branch, train the managers and staff, and conduct a pilot project in market penetration
19. Revise market penetration methods as needed and gradually introduce the systematic approach to all branches
20. Develop appropriate strategies for investing excess liquidity

2. *Review the country's political economy, regulatory environment, and supervisory capacity for regulated MFIs*

Five main preconditions were discussed in Part III, section 3. Three of these—at least a moderately enabling political economy, a reasonably appropriate policy and regulatory environment, and an adequate capacity for public supervision of MFIs licensed to take deposits—are largely beyond the control of MCIs that want to transform to regulated financial intermediaries. Nevertheless, these must be carefully reviewed in the institution's (and the regulatory authority's) decision-making processes. If the country is in a period of hyperinflation, if interest rates have not been liberalized, or if central bank staff have not yet been trained to supervise regulated MFIs—the time is not right for transformation. But in many countries such conditions are not now a constraint, or remaining problems are in the process of being resolved. And licensing of transforming MCIs can (and is) going forward in quite a number of countries.

> ***Watch out for:*** *The "we will do it anyway" approach. Going ahead despite any obstacle is not advisable. For example, if regulatory authorities do not permit an interest rate spread that will cover all costs and risks, including the substantial labor costs involved in collecting public savings, the MFI is heading for trouble if it goes ahead. Similarly if overly restrictive regulations prevent the opening of new branches or sub-branches, savings will be limited (borrowers will travel far, savers will not). In such cases, MFIs should join with others—both domestically and in the international microfinance community—to educate their governments about commercial microfinance, and about the need to change regulations that result in the exclusion of large numbers of low-income people from the financial system.*

3. *Review the history, capability, and performance of the MFI*

The last two preconditions discussed in Part III—a strong institutional performance record and experienced management with strong financial skills—are crucial. Before mobilizing voluntary public savings, an MFI should become a publicly regulated financial institution. It must have demonstrated responsible and qualified ownership, effective governance, experienced and financially skilled management, substantial outreach, and financial self-sufficiency. And it should have a culture of accountability and a several-year audited record of excellent performance. The MFI should be efficient and transparent, with its accounting methods adhering to international standards. Its track record should show that it regularly earns good returns, maintains a high rate of timely loan repayment, and demonstrates prudent asset-liability management as well as good financial management overall. And the MFI should have earned a good reputation in the area it serves.

> ***Watch out for:*** *Rose-colored glasses! MFIs must take a hard, objective look at themselves (with the help of outside ratings) and analyze carefully whether they are really ready to mobilize and intermediate public savings.*

4. *Assess internal capabilities, identify gaps, recruit new staff as required, and retain outside experts as necessary*

Transforming MFIs generally do not have in-house management and trainers who are experienced in voluntary savings mobilization and competent to train managers and staff in collecting public savings and carrying out financial intermediation. Such institutions generally lack many of the resources and skills needed for building and managing large-scale savings facilities, for undertaking financial intermediation, and for managing rapid growth. They may also be inexperienced in research on savings demand and in the design, pricing, and delivery of savings products (and individual loan products as well). Sometimes MFIs hurriedly hire local bank staff, who often turn out to be the wrong people for the job. Initially the institution may want to send managers to international microfinance training programs—but these programs need to be carefully selected, as many provide little information about savings.

At this stage MFIs usually need internationally-experienced outside experts to work closely with management in assessment of internal capabilities and in recruitment of new managers and staff—and on the MFI's overall planning, research, and sequencing. Donors have begun to play an important role here by funding some or all of this kind of expertise for a year or so at the time of an MCI's transition to regulated status. Such outside experts are brought in to work with management in demand research, product design, product delivery, pilot projects, cost studies, accounting and auditing, internal controls, and the like. They also help to train the institution's trainers, as well as head office, regional office, and branch office managers and staff.

> ***Watch out for:*** *Ignorance—it is not bliss, and it can hurt you! Newly-regulated MFIs need to go slow at this stage and make sure they know what they are doing. However, they may now be pushed by their owners, boards, or managers (or in some cases by regulatory authority deadlines) to mobilize savings soon after they are licensed to do so. Those taking this position are often unaware of the risks of opening voluntary savings facilities before the MFI is ready. Outside experts, as needed, should be involved in helping the institution at this, and other, stages of the sequencing. Outsiders can sometimes also help by discussing with owners and managers the basic reasons that the MFI should not begin collecting savings until it is well prepared—and by explaining the considerable risks of not accepting this view.*

5. Conduct research on demand among potential savers of different kinds, and on the supply of savings facilities among competitors

Demand research must be carried out to learn the views of current and potential clients about savings products and services. And research on what the competition is doing is important for product design and pricing.

Because the transformed MFI will need to attract savings from middle- and higher-income clients and from institutions, in addition to low-income savers, samples of all types of savers should be included in the demand research. And the MFI's managers and staff need to be trained in how to identify, interview, and interest such potential clients in the institution's new savings program. As noted, the MFI's first task in demand research is to learn in what forms and for what purposes people in the area to be served are currently saving—and what they like and dislike about their current options. Accurate answers to these questions can be elicited only by in-depth interviews, and experts are usually needed to guide this process in the beginning. Questionnaires can be used effectively after the first pilot project—when the institution has learned what questions to ask, how to ask the questions, and how to understand the answers. It is the knowledge that comes from this process of learning about savers that enables an MFI to design products and services that combine the characteristics of informal savings methods that savers like, with solutions to the problems of informal savings methods they dislike. This information is essential input for the MFI's product design stage.

Research on the competition is somewhat easier, but also needs to be carefully done. A transformed MFI entering the savings market needs to know which competitors have what market segments and shares, what the competitors' comparative advantages and disadvantages are, what products and services they offer, and what their respective clients like and do not like about the services they receive. An accurate assessment of the competition in the service area to be covered is a strong advantage for a newcomer to this market.

Some transformed MFIs contract their research out to local research firms. But serious problems of various kinds can arise from this approach. Often such firms—even those experienced in other kinds of research—are not competent to conduct these kinds of field research or to analyze the results at a quality level. The reported results may be useless—or worse, accepted and used by the MFI. Also by using this

approach, the MFI's managers and staff do not acquire the field experience they need to comprehend the complex conceptual frameworks within which their potential savers make decisions about savings, as well as the strategies and tactics employed by their competitors. And the MFI will not gain the in-house experience needed to train its staff in these research methods. However, the capacity of some research firms to carry out these kinds of work is beginning to improve. This early trend should accelerate in the future as the commercial microfinance industry (and its profitability) becomes more widely known, and as the opportunities the industry affords for research become better understood.

But the best option for transforming MFIs today is to have internationally experienced outside experts working closely with their own managers and staff to conduct demand research (the relationship between MicroSave-Africa and its MFI partners is an excellent example of this approach). If a research firm is used, it should be carefully vetted by outside experts, and it should conduct the research as a team with the MFI's own managers and staff. The demand research should not be entirely, or even largely, contracted out.

> ***Watch out for:*** *Missing the market, while misinterpreting the demand! Managers and staff who come from microcredit organizations may be uncomfortable interviewing middle-income clients and heads of local organizations and institutions that are potential savers. They may also have difficulties learning about competition from banks and larger financial institutions. In such cases they may be unable to obtain accurate information (and may not report, or even know themselves, that the information is inaccurate). And staff who are not well trained in savings may have a tendency, especially when interviewing low-income people, to put words in respondents' mouths, rather than listening carefully to what they say. But contracting out demand research does not resolve these problems, and it adds others. Outside experts should be closely involved, as needed, in the research and analysis and should work closely with the institution's managers and trainers.*

6. Design and price products and services for the pilot project

When the research on demand and on the competition has been completed and its results analyzed and discussed by managers and staff (with outside experts where needed), trial products and services must be designed for use in the first pilot project. Information from the demand research should be used to design a few simple products. A good package of products with which to begin consists of a passbook savings account with unlimited withdrawals, a fixed deposit account, and a limited withdrawal account. Pricing products for the first pilot project is difficult because neither the costs nor the extent of demand for the different products is yet known. There is no one right way to design these accounts, but some things seem to work better than others. Some thoughts on product design and pricing are given below.

> ***Passbook savings account.*** This is the single most essential account, as there is enormous demand for a savings account with unlimited transactions. Savers who open other types of accounts usually open a passbook savings account as well. Although some passbook accounts do not provide interest, an interest-bearing account is a better option for an important reason. Fully liquid passbook accounts are very popular, but they are generally labor-intensive accounts. If the MFI offers a passbook account to large numbers of poor people with small account balances, the average account size must be raised with larger accounts. And larger account holders tend to be interest-sensitive. Thus the pricing of the passbook account is crucial. It should be designed with a tiered interest rate so that no interest is paid on minimum monthly balances up to a certain amount (say, $10-$25). But the largest savers—who are crucial for the viability of the product— must be paid market rates. In between there should be one or two tiers of interest rates, depending on how the account size distribution falls.

Fixed deposit account. Fixed deposit accounts are useful for a wider range of savers than is generally understood. These accounts should be offered with one, two, and three-month maturities, in addition to accounts with longer maturities. To be competitive, fixed deposit accounts must offer market rates to all account holders.[14] Middle- and high-income savers use fixed deposit accounts, as do local businesses and institutions. But these accounts are also used by some low- and lower-middle-income savers who generally choose the shorter maturities. Thus some farmers, fishing people, and others with irregular seasonal incomes use the accounts to store excess liquidity at high season for use during the low season. Some artisans use fixed deposit accounts as well. They monitor the prices of the raw materials they use on a monthly or bi-monthly basis. If the price is low, they close the account and purchase the materials they need (wood, leather, cloth, cement, and the like). But if the price is high, they roll over their accounts and wait for the price to drop. And some low-income people use these accounts as well for long-term savings goals (weddings, funerals, education, ceremonies, pilgrimages, house repairs, business expansion, etc.). Fixed deposit account holders often also hold passbook savings accounts.

Interest-bearing, limited withdrawal account. Savings accounts of various types featuring returns combined with limitations on the number of withdrawals generally fall between passbook and fixed deposit accounts in liquidity and returns—and also for transaction costs (which are usually highest on the passbook account and lowest on the fixed deposit account). This intermediate account may offer interest on all deposits, while restricting the number of withdrawals (or charging fees for withdrawals above the number permitted). Typically the interest rate for limited withdrawal accounts is lower than the rates for both the highest tier of the passbook account and the fixed deposit account. The intermediate account is usually more liquid than the fixed deposit account, and less liquid than the passbook account—but it provides some interest for all account holders. This account thus provides an opportunity for small account holders to obtain interest on their deposits. Some use these accounts to save for rent payments, for paying employees, or for other regular weekly or monthly expenses.

The limited withdrawal account is also a product that can be politically useful for the institution. People with very small financial savings are generally not eligible for the fixed deposit account because it typically has a relatively high opening balance. And such savers would also not normally receive returns on their passbook accounts—because their monthly balances would be below the minimum required for payment of interest. This leaves an opening for political criticism that the institution pays interest to rich savers but not to poor ones. Such criticism can be deterred by the limited withdrawal account. Inquiring politicians and journalists can be shown that savers with very small accounts are free to choose between a passbook account that provides no interest on such small balances, and the limited withdrawal account that pays interest but limits liquidity. In my experience, most low-income savers with small accounts choose liquidity over interest. The limited withdrawal account is not generally a very popular account. But it gives people a choice, and it can be politically advantageous. And it is useful for rounding out the initial package of savings products—which clients use in various ways, customizing their savings portfolios to meet their particular needs.

Lotteries. If country regulations and local culture permit, the liquid and limited withdrawal accounts can have a lottery attached to them, whereby savers receive free lottery tickets each month based on their minimum monthly balances (for example one ticket for every $5 or $10 of savings). Such lotteries are often run semi-annually. If the first prize is a large one (a motorcycle, car, or a substantial amount of cash), and if smaller prizes are also given out, lotteries are generally very popular with savers and encourage saving.

[14]Somewhat lower rates can sometimes be used in remote areas where there is little competition and where the MFI may have higher transaction costs. This holds both for fixed deposit accounts and for the highest interest rate tier in the passbook savings account.

Keep it simple and efficient! These three accounts are a good way to start. Though it is not easy, these accounts can be administered efficiently and effectively even in the first years. And the combination of the three accounts is popular. BRI's microbanking system has used a combination of such accounts for nearly 20 years now, and it has been profitable every year. As of 2003, BRI has $3.3 billion in 30 million savings accounts in its microbanking system. Its fully liquid accounts (with tiered interest rates) account for 87 percent of the value of its savings and for 99 percent of the number of its savings accounts. Of the three types of accounts, this is the one most difficult to design, price, and implement (see Robinson 2002a, chapter 13). But it is well worth getting it right.

It is also useful to analyze what savings products do well among the competition. There may be local variations on what products are popular, and this is well worth investigating. MFIs can, of course, add other special accounts later on, if they consider them feasible, cost-effective, and in demand—for example, long-term fixed deposits for education, housing, and retirement; checking accounts; savings accounts that are coupled with loans (a loan is provided after a contractual savings requirement has been met); and others. But it is best to start simple.

> ***Watch out for:*** *Too many products and too low an interest rate spread. Offering too many products, especially in the first pilot project, makes the pilot difficult to manage and expensive to administer. It is not necessary to provide all the products that savers may have mentioned during the demand research. What is essential is to design a small number of complementary products so that each client can customize the use of these products to suit his or her own needs. The interest rate spread must be set carefully and interest income estimated to cover the operating costs of savings mobilization at the pilot project [one-time start-up costs should budgeted separately]. Interest rates for loans may need to be raised.*

7. Create a checklist: Is the necessary institutional capacity in place to open voluntary savings facilities to the public?

The MFI's management (advised by experts and overseen by some board members) should check carefully for overall institutional readiness for mobilizing public savings. A checklist is needed—consisting of the tasks that must be completed before voluntary savings accounts are offered in the first pilot project. The contents of the list will vary somewhat depending on the country, the MFI's history, and other factors. Nonetheless, some requirements are essential for all newly-regulated MFIs; others can be added as necessary for particular environments or special circumstances. Some examples can illustrate the kinds of institutional capacities that are required. Thus the questions below must be answered affirmatively before the MFI begins its new voluntary savings program in the first pilot branch.

- Have all outstanding legal matters and ownership issues been resolved?
- Is an appropriate governing board in place?
- Is the management capable of operating a rapidly-growing financial intermediary?
- Is the financial management team in place, trained, and ready? Do they have the facilities they need?
- Is the management information system (MIS) appropriate and reliable? Is it capable of accurate tracking of deposits and withdrawals. Do managers and staff know clearly how to operate it, and are they able to use the information that is generated to make timely decisions?
- Have the MFI's physical infrastructure (its head office and any regional offices, and branches and any sub-branches), its communications, and its transportation facilities been carefully evaluated in light of the new demands to be placed on them? Have the plans for needed changes, including increased security, been made, and have the costs been estimated? Are the funds available for the necessary upgrades of facilities?

- Are the internal controls and the internal supervision processes ready and tested? Have appropriate reporting, bookkeeping, and internal audit systems been set up?
- Where needed, have new methods and procedures been designed, documented, and tested?
- Have the MFI's treasury management, asset-liability management, and liquidity management been revised to reflect the MFI's new financial responsibilities?
- Has the cash management system been established, and the transfer price mechanism planned?[15]
- Do the Human Resources managers understand the changes that will occur in the institution—and the ways in which these will affect recruitment, training, staffing, and distribution of responsibilities? Are they capable of moving ahead in the new directions required? Are they on board?
- Are appropriate training programs and performance-based incentive systems in place and fully understood by managers and staff?

Watch out for: *(1) The common syndrome: "We're too busy now. Let's just start collecting the savings and do the rest later." Completing the requirements on the checklist must precede the opening of the new savings program. Inverting the sequencing order will result in quite rapid, extended, and costly chaos—which will probably also have a negative effect on the MFI's reputation. (2) Perfunctory answers. Affirmative responses to the above questions should be backed with compelling evidence (that the board should request).*

8. Develop criteria for a pilot project site and select the pilot branch

When developing criteria for the location of the first pilot project, a number of factors need to be taken into account. There will undoubtedly be considerations related to specifics of the country and region, including demography, infrastructure, politics, and the like. But there are also important criteria that apply generally. Thus the pilot branch should have a track record of performance in the top quarter or so of the MFI's branches, but should not be among the very best. It must be an experienced, well-performing branch because if the first pilot does not succeed, there are not likely to be others. But the pilot branch should experience the same kinds of problems that are likely to be encountered by other branches later on.

- The population in the pilot location should be reasonably typical of at least a major portion of the country.
- The location should be above average for population density and should have a mixed market economy.
- The pilot branch should be located in a province and district that are reasonably peaceful, and where the political authorities are not heavily engaged in subsidized microcredit and opposed to commercial microfinance.
- The branch selected should be not more than about two hours from the head office on dependable roads, as high-level managers must be at the site frequently. But the pilot should not be conducted close to the head office. Among other reasons, mistakes will inevitably be made, and it is best to make them in a less visible place!
- Adequate space will be required at the branch for a substantial projected increase in the number of clients. The branch will also need space to accommodate additional staff, as well as some on-the-job trainees from other branches. The spatial layout of the branch building must allow for this expansion.

[15]The transfer price is the interest rate on funds that are deposited by the MFI's lowest-level outlet (unit, sub-branch, etc.) into a higher-level office (branch or regional office), or that are borrowed by the sub-branch from the branch. The rate, periodically adjusted by the head office according to the overall liquidity position of the MFI, is used to indicate the relative emphasis that the head office wants placed on savings and loans.

- The pilot branch should have a good operational and financial performance track record for at least three years. It should not have any major organizational, management, or operating problems—for example, endemic staff conflict, recent fraud, high or volatile portfolio at risk (PAR), and the like. On the contrary, the pilot branch should have a good reputation in the area it serves.
- A highly qualified branch manager must be responsible for the pilot branch—a person with strong leadership experience who is experienced, financially skilled, hard-working, open-minded, committed, and motivated. Ideally the pilot branch selected would already have a well-qualified manager who knows the service area. But if the branch that best fits the other requirements does not have such a manager, another manager can be transferred there. But one way or another, a well qualified branch manager is essential for the first pilot.

Watch out for: *(1) Too many branches in the pilot project. MFI boards and managers often have a tendency to want to conduct a number of pilot projects in different areas right at the start. This is a serious mistake. The first pilot is difficult, and it requires the constant attention of high-level managers from the head office. The pilot should be carried out only in one limited service area, although all the MFI's sub-branches and other outlets in that area can be included. (2) Selecting a favorite branch in an inappropriate location. Board members and managers sometimes have their own favored areas and may want the pilot project to be located in a particular branch for personal or political reasons. Informing them early in the process about the selection criteria—and the reasons behind them—helps to mitigate problems of this kind. (3) Selecting a branch in a hostile political area. (4) Selecting a pilot branch that does not have a well-qualified manager, and not transferring a highly qualified manager to the pilot branch.*

9. Prepare for the first pilot project—a complex and multi-faceted task

This is a crucial step that too often is dangerously shortened because the board or the Chief Executive Officer (CEO) wants to get savings started quickly—usually because the loan portfolio is expanding. This is not the time to rush savings mobilization in order to finance loans (it is also not the time for major expansion in the loan portfolio). If additional funds are required for the portfolio, the MFI should borrow from financial markets. In addition to the checklist for the institution discussed above, another list needs to be prepared for the preparations to be made for the pilot project itself. The pilot branch management and staff will need to be trained, the building may need to be renovated, operations will need to be revised, and the logistics for the introduction of voluntary savings products and services (and the documentation of their results) must be organized. Examples of questions that need positive responses before the pilot project opens for savings collection include:

- Have the regulators given final permission for the MFI to mobilize public savings? Have all necessary forms been completed and approved, and has the license to take deposits from the public been issued (and other requirements met)?
- Have the head office managers and the pilot branch manager taken an active part in the planning of the pilot project, and have they demonstrated that they are capable of running the pilot?
- Have the appropriate high-level managers at the head office allocated substantial portions of their time to the pilot for an extended period? Have others been appointed to take over some of their other responsibilities? There will undoubtedly be problems and mistakes in the pilot. But the pilot must succeed if the MFI is going to become a financial intermediary—and it is the responsibility of the head office to make sure that the pilot works!
- Have prototype products, delivery mechanisms, and simple manuals been developed? (These will be revised later when the results from the first pilot are known).
- Is an appropriate MIS system in place and tested at the pilot branch, and are the branch managers and staff able to use it effectively?

- Have the record keeping systems for monitoring the pilot project and for analyzing its results been set up, and are they ready to be used? These would include, for example, recording the number of savers and amount of savings by product; the account size distribution by product (crucial for setting interest rates when the savings products are introduced in other branches); and the information needed for cost analyses—including labor costs—by product. Also, in the financial reporting, start-up costs such as extensive training, renovation of buildings, and purchase of new security systems and of MIS for the pilot branch should be accounted for separately from recurring costs. If grants or subsidized loans are provided for these capacity building expenses (an excellent use of donor funds for highly promising institutions), these should be accounted for separately. And in the financial statements of the branch, adjustments should be made for any grants and subsidies used.
- Have arrangements been made for careful monitoring of the loan portfolio so that in the midst of all the new savings activity, portfolio quality does not decline?
- Training of the pilot branch staff takes place at this stage—a crucial activity that requires considerable continuing attention from the head office. Qualified and experienced trainers are needed to conduct the training sessions, and sufficient time must be allowed for the training sessions. One month, including fieldwork among potential savers (who should not live or work in the service area of the pilot branch), is about right for most institutions. In addition to the pilot branch personnel, members of the MFI's training department and a few managers and staff from other branches should be trained at these pilot training sessions—so that there will be trainers and staff reserves to draw upon as the savings program is gradually rolled out to other branches. Participants should be tested and evaluated. At the end of the training, a careful review is needed.
- Have simple, local marketing strategies been developed? (This is not the time for a major marketing effort). Are managers and staff able to explain accurately and understandably to prospective clients the comparative advantages of each product, and how the products can be used together to meet a client's particular needs?
- Has a draft been developed of the general criteria that will determine when the pilot has achieved sufficiently good results for the MFI to proceed safely to the next step? These must be general criteria, not specific targets. The criteria should be designed for a six-month evaluation of the results for each product, as well as for the overall pilot (step 11). These draft criteria will be used to rate such indicators as branch resources, level of outreach to low-income savers and to other individuals and organizations, amount of savings, account balance distribution, and average account balance (is it high enough for institutional profitability?). Also included are measures for ascertaining whether operational efficiency, product costs and pricing, and the blended cost of funds are suitable. Others focus on PAR, results from confidential customer and staff feedback; and a variety of additional indicators. The draft criteria should be revised during the pilot, as more information becomes available on the challenges, risks, and strengths of the branch's performance.
- Has the branch been renovated (if necessary), and is the use of space appropriate for the activities to be carried out? Is the space in the branch suitable for rapid expansion should this become necessary?
- Are the branch's transportation and communications facilities adequate?
- Are there enough cashiers?
- Is the branch neat and attractive, with information about the new products clearly posted?
- Are the security arrangements adequate and have they been tested?
- Are there sufficient supplies of bankbooks, forms, brochures, and other supplies on hand? (It is amazing how often this is forgotten!).

Watch out for: *(1) Haste! The pilot project should not be started until both the pilot branch and the head office are ready. (2) Underestimating the difficulties and the management needs of the pilot project. The MFI should keep in mind that it cannot go forward with savings mobilization until the first pilot works—and that there is no replacement for sufficient, high quality management resources. This needs to be planned from the start—and implemented throughout.*

10. Conduct the first pilot project, ensuring that adequate resources are available (and used) for close supervision and regular, careful monitoring

The aim of the first pilot project is to introduce the new savings projects successfully, to maintain a high quality loan portfolio, to remain profitable—and to learn from the experience. As discussed, the primary objectives of the first pilot include testing both the new products and the ability of the pilot branch to deliver them effectively; monitoring costs by product and preparing any pricing revisions that may be needed for the next stage of the program; testing information, communication, and security systems; training managers and staff; and testing a performance-based incentive scheme suitable for a financial intermediary.

When the items on the checklists discussed in steps 7 and 9 above are complete, the MFI is ready to open its doors to savers. At this point, MFIs have a tendency to want maximum publicity in advance of opening their new savings program. But this must be avoided. The MFI should publicize its new savings program locally and quietly at first. Otherwise the institution may be swamped with large numbers of savers before it is able to serve them adequately.

Another tendency at this stage is to place general targets on savings amounts and numbers of accounts, as well as targets for specific products. Both should be resisted. The pilot project is not the time for savings targets (one reason is that no one has any idea how to set such targets). A general target may result in more savings clients than can be responsibly handled at first, while the resultant overload on the branch can result in a decline in the quality of the loan portfolio.

Product targets are also counterproductive for an MFI that is trying to learn what products savers want, and what it costs to deliver these products. If a saver wants a passbook account, but the staff sell her a limited withdrawal account so the branch can meet the target for that product, the MFI will not get the information it needs. And savers using products inappropriate for their needs are unlikely to stay long. Staff should explain products and their uses to clients. They should not try to sell one product over another (which will happen if product targets are introduced).

During the pilot project, especially in the first few months, head office managers should be available on a daily basis to troubleshoot and to monitor and analyze results. There is considerable evidence indicating that even when pilot staff are well trained in new products and methods, a long period typically elapses before the new approaches and attitudes are firmly ingrained at the branch. Close monitoring, supervision and on-the-job coaching are key.

The pilot project should be analyzed and evaluated on a weekly and monthly basis for the first six months. Customers of different types should be interviewed, and both praise and complaints should be recorded and analyzed—for immediate action and future use.

This is also the time to revise and refine the criteria (developed in step 9) that will be used for the more formal six-month overall evaluation of the pilot (step 11). The evaluation should indicate clearly whether the products meet specific client needs, whether they are priced to enable profitability, whether managers and staff are qualified for their new responsibilities, whether operations and product delivery are effective and

efficient, whether portfolio quality remains high, and overall, what the effects of the pilot on branch outreach and profitability have been.

Specifically, costs need to be carefully monitored by product (including operating costs and costs of funds). Minimum monthly account balance distribution must be carefully watched, as the results will be needed for setting interest rates in the second pilot. MIS and other systems need to be tested. Asset-liability and liquidity management must be closely monitored. Accounting, reporting, and audit need to be regularly reviewed, as do internal controls and supervision. Space use should be analyzed. But unless problems are very serious, it is best not to alter the products, services, and pricing during the first six-month period. Such changes may confuse or disappoint customers and they could also make the results of the pilot difficult to interpret.

The morale of branch managers and staff also needs to be examined They may feel confused, overworked, or under-appreciated—or all of the above). More staff (and space and computers) may need to be added. If gaps are found in training, or incentive programs are not serving to motivate staff, these should be recognized as matters that must be addressed quickly by the head office. And the ongoing activities of the branch need to be continued at a high level of quality. This is a difficult time for managers and staff. But frequent recognition and praise from the head office for achievements can go a long way toward heading off staff demoralization. At the end of six months, materials should be prepared for a careful overall review of the pilot (see step 11 below).

Appendix 1 provides a case study of a recent example of sequencing the introduction of voluntary savings up to the completion of the first pilot project. The Dominican Republic's Asociación Dominicana para el Desarrollo de la Mujer (ADOPEM), an NGO that bought a bank in 2003, has thus far introduced voluntary savings services in the bank through the stage of operating the first savings pilot project (step 10). Some of the actual decisions, problems, and achievements that can occur during the first half of the sequencing process are shown there. It is a particularly interesting example because the transition is occurring during a major financial crisis in the country, thus illustrating well a worst-case environment for transforming NGOs. And yet the bank so far is making reasonable progress.

ADOPEM expects to evaluate the pilot (step 11) in the last quarter of 2004 or in early 2005. This example gives some clear insights into the first half of the sequencing process, and shows what an MFI can gain from the process. Analysis of the entire sequencing process is available for Indonesia's BRI (Robinson 2002a, chapters 13 and 14).

> ***Watch out for:*** *(1) Requests for quick results by the CEO or board. (2) Difficulties in branch management. (3) Decline in loan portfolio quality.(4) Very low average account size. (5) A high weighted cost of funds. (6) Mismatched asset-liability structure (for example long-term loans and short-term savings). (7) Publicity about the savings products that is too early and too widespread. (8) Long lines and client complaints. (9) Security lapses. (10) Overworked and demoralized staff. (11) Inadequate internal controls. (12) Problems with MIS and security systems (13) Poaching of best managers and staff by competitive MFIs (if the pilot is successful, word will get around!).*

11. Assess pilot results and revise products, pricing, operations, MIS, etc. as necessary. If needed (very likely), prepare the revisions and manuals for the second pilot.

At the end of six months of operating the first pilot, the head office (with help from outside experts) should carry out a careful assessment of the operations and results of the pilot project. The evaluation, which can be carried out simultaneously with some of the planning for the second pilot, should take about one month.

This evaluation should include calculation of standard indicators and ratios for financing structure, financial performance, outreach, efficiency, productivity, and risk and liquidity (and others that may be relevant). Start-up costs should be calculated separately. Indicators and ratios for the pilot branch should be compared with those of similar branches at the MFI that do not yet have voluntary savings. In addition, review and analysis should be carried out for the following items (and others):

- Client satisfaction with products and product delivery (a representative sample of savers should be interviewed)
- The number of accounts and amount of savings by product
- The economic activities and other characteristics of the savers and their households
- The number of savers with multiple accounts (a sample of these savers should be interviewed to learn how they use the different accounts—this information will help in later stages of introducing new products to potential clients)
- Asset-liability, liquidity, and cash management
- MIS and communications
- Security
- Backroom operations
- Analyses of costs by product (including transaction costs), and of interest rate spread
- Loan portfolio quality
- Management and staff capability and work load.
- Management and staff training, incentives, and morale
- Other specific achievements or problems of the pilot project that can be useful for designing and delivering the institution's products and services in their other branches

After the review, the MFI should decide whether the pilot has achieved sufficiently positive results for the institution to move ahead to a second pilot project. If the results are not sufficiently clear or satisfactory, the problem areas should be addressed and the first pilot continued. However, if the results are generally good—savers like and use the products, managers and staff are well trained and active, the loan portfolio quality is high, and the interest rate spread is sufficient for profitability—the MFI is ready to move to a second pilot, incorporating specific revisions as necessary in products, pricing, operations, training, incentives, management and staffing, and the like.[16] At this stage the manuals should be revised.

> ***Watch out for:*** *A too-rigid schedule. Boards and managers have a tendency to schedule pilot projects for specific periods and then to move on to the next stage according to the calendar. The answer to when the MFI is ready to move on to the next stage cannot be found on the calendar. And that approach can cause very serious difficulties later in the sequence. The first pilot can take from six months (a minimum for useful results) to a year, and longer if serious problems arise. The products and operations being tested in the pilot should not be offered elsewhere until they work well enough in the pilot branch to be revised and used in other branches with reasonable confidence, and until the costing and pricing are well understood. The findings from the review of the first pilot are then used to design revisions to products, pricing, and operations that will be tested in the second pilot.*

12. Plan the second pilot, selecting branches located in different environments

As the products, pricing, and operations of the first pilot are being evaluated and revised as needed, the second pilot must be planned and the new pilot branches selected. As noted, some of this can be carried out

[16]A reader who commented on this paper when it was in manuscript, said that it might not be "totally clear" to readers how the decision should be made at this stage whether to revise and continue the first pilot project or to move on to a second pilot. It is never totally clear. At this point, it is a judgment call. The only answer lies in having managers with good judgment.

during the evaluation of the first pilot. Steps 12 and 13 together should take about one month on average. The second pilot is relevant mainly for medium-sized and large institutions, as some small institutions with only a few branches can use the gradual rollout to all branches as their second learning experience. MFIs that are small, that had excellent results in the first pilot, and that are not geographically dispersed can skip the second pilot, but MFIs that do not fit all these criteria should not do so.

As noted, the primary purposes of the second pilot are to test all the changes from the first pilot that are to be introduced; to test the revised savings products in multiple environments; and to test the ability of the head office to coordinate the introduction of savings mobilization simultaneously in different areas. Depending on the size of the institution and its management capacity, the second pilot could add 2-10 branches to the ongoing first pilot branch.

The second pilot is also the time to introduce two other important changes. One is to begin offering individual loans (or where relevant, expanding the number of such loans). It is usually too difficult to do this in the first pilot but for reasons discussed earlier, the MFI's capacity to evaluate individual loan applications and to make and collect such loans is an important component of its savings mobilization effort. The other key change is to phase out compulsory savings. As discussed in Part I, compulsory savings provide savers with multiple disadvantages, and therefore many do not want to place voluntary savings of significant amounts in institutions that require mandatory savings. Financial intermediaries that are industry leaders serving microfinance clients typically do not require compulsory savings.

The phasing out of compulsory savings should take place after the new savings products have been introduced in the pilot branches, and when these branches are operating fairly smoothly. At that stage borrowers can be told that they no longer need to maintain compulsory savings, but should be encouraged (not forced!) to move their compulsory savings to one or more of the new savings products.

Both these innovations should be tested in a quarter to a third of the branches in the second pilot (and a minimum of two branches in small institutions). The branches need not start these two activities at the same time, nor do the branches need to undertake these changes simultaneously. Each should start when the head office and the branch manager think the branch is ready.

For reasons discussed, the first pilot branch must be fairly close to the head office. But the branches in the second pilot can be further away, and they should represent a range of geographic and demographic conditions, economic activities, political environments, infrastructure and communication facilities, and levels of competition. However, all selected branches should have experienced branch managers with above average performance records and an interest in learning and implementing new approaches, products, and services.

The first pilot branch should be continued along with the branches of the second pilot, both because its clients need continuing service and because the first branch is a source of longer time-series data. But revisions should be made in products, pricing, operations, and the like, so that this branch is operating with the same products and procedures as the new pilot branches.

> ***Watch out for:*** *(1) Underestimating the difficulties and the management needs of the second pilot project in its planning stage. Introducing public savings on a large scale is a management-intensive effort at each stage and every level. A sufficient level of continuing high quality management resources is a sine qua non of moving forward at this stage. (2) A mismatch between the number of pilot branches selected and head office management capacity. The second pilot requires substantial head office coordination and rapid troubleshooting, and it involves considerable management and staff training as well as*

extensive travel to the various pilot branches. If high-level management is not available on a continuing basis, serious problems can develop quickly. (3) Possible resistance, especially from some former NGO staff, to the introduction of individual loans and to the phasing out of compulsory savings. If such resistance occurs, it is likely to come from management and staff—not from clients!

13. Train managers and staff of the second-stage pilot branches

As soon as the branches have been identified, their managers and staff should be trained at the head office in the new concepts, products, and operations to be tested. The experiences of the first pilot should be thoroughly reviewed as part of the training. The participants should then be assigned on a rotating basis to several weeks of "on-the-job" training at the first pilot branch. To the extent feasible, managers and staff involved in the first pilot branch should help in the training for the new pilot branches. Also by this time there should be some in-house trainers capable of providing this type of training—some of it general, and some specific to particular positions (manager, cashier, bookkeeper, internal supervisor, and the like). But outside trainers will probably also be needed to meet the training needs of the second pilot.

A "flying squad" should be established at this time. This is a small team of people who are trained to be experts in operational aspects of introducing savings mobilization and in financial intermediation. Members of this team will then be available to travel to any of the pilot branches for troubleshooting (and they will be available later in the rollout phase when the savings products are expanded to all branches).

Managers and staff located in the pilot branches selected to introduce individual loans and phase out compulsory savings need to be well trained in evaluating individual loan applications and in encouraging borrowers to move their compulsory savings into one or more of the new savings accounts now being offered. Once these pilots are running, selected managers and staff from the other pilot branches should be sent on a rotating basis for "on the job" training at these pilot branches, so they will be better prepared for the rollout stage.

Watch out for: *Inadequate head office coordination and insufficient or inappropriate training of branch and sub-branch staff. The introduction of new products and services in multiple pilot branches simultaneously is difficult. It requires both careful training and a performance-based incentive structure that is perceived as desirable, fair, and uniformly implemented. If branch managers and staff are not well trained in how to explain the new products and services to customers and in how to deliver them effectively, the results can include low staff morale, inefficiency, high costs, low savings, and a deterioration in both the institution's portfolio and its reputation.*

14. Implement and evaluate the second pilot

Implementation of the second pilot is similar to that of the first pilot, except that it requires far more coordination. Needed changes in the first pilot's products, pricing, operations, reporting, incentives, supervision, and the like must be made, and the revised program then introduced in all the pilot branches. In each branch, accurate and transparent records must be kept of the performance and the costs of the revised products. And the loan portfolio quality of each branch and sub-branch has to be carefully watched (with immediate action taken in case of missed payments). Steps 9-11 above need to be followed carefully in all pilot branches.

Evaluation of the branches in the second pilot should be conducted after about six months of operation. The first pilot branch should be re-evaluated at the same time. About two months are then required for the full evaluation (the amount of time needed depends on the skill of the evaluators, the size of the institution,

and the results of the pilots). At that point the decision should be made whether to continue the pilots or to move to the rollout stage. If the latter decision is made, it will then take at least another month to revise products, operations, and pricing as necessary for the rollout; and to plan and organize the large-scale training program that will be needed for the rollout of the savings program to all branches. The time required will depend on the management resources devoted to this effort, and also on the size of the institution and the results of the pilots.

> ***Watch out for:*** *(1) A substantial increase in the complexity and demands of the work (often not sufficiently anticipated). Head office managers must now analyze far more data than in the first pilot branch, troubleshoot quickly wherever needed, and focus on understanding the reasons for major difficulties and significant differences in performance among the pilot branches. These are lessons that must be learned before the products are rolled out to all the MFI's branches. For example, in branch D a product does extremely well but there are few takers for the same product in branch G. Why? Or a product is successful in all branches but is very costly in some and not in others. What are the reasons? Do the problems arise from inefficiency, too low an average account size, poor management, untrained or unmotivated staff—or various combinations of such factors? The reasons for the problems that arise and their solutions need to be understood. Any major difficulties should be resolved at the pilot stage to avoid widespread problems at the rollout stage. (2) Rushing this step. MFIs should not move to step 15 until they are sure they have got this one right! (3) If these pilots are perceived locally as being successful, attempts by other institutions to hire the best managers and staff are likely to increase.*

15. Train senior managers and trainers for the rollout phase

At this stage in its savings effort, the MFI should have a core group of head office managers, branch managers and staff, trainers and a flying squad—all of whom who have been involved in the pilot projects and are knowledgeable about the savings products, pricing, operations, intermediation, and other aspects of the savings facilities to be offered to the public. However, the other managers and staff of the MFI typically know relatively little about these products and processes, and they need to be brought up to speed before the rollout takes place.

There are two main objectives at this stage. The first is to conduct a short, but intensive training program so that all the MFI's senior managers are knowledgeable about savings mobilization in general, and in particular about the planning for the institution's development as a financial intermediary. This savings training program should take about four days on average and should cover all aspects of the first and second pilots, lessons learned, and plans for expansion. A wide variety of issues needs to be covered, including treasury management, asset-liability management, liquidity and cash management, transfer pricing, funding needs for startup costs, MIS, infrastructure, security, internal controls, accounting, reporting, client profiles, customer service, staffing needs, training, and others. Exposing all head office managers and senior staff to the main issues at this juncture is well worth the effort. Also, a summary of this training session should be provided in a half-day session at a board meeting (with longer briefings for interested board members).

The second objective is to provide extensive training to the group of trainers and managers who will be responsible for training all MFI personnel in the regions, as part of the gradual expansion of savings mobilization to all branches. Depending on the size of the institution, there may not yet be a sufficient number of qualified in-house trainers to train the trainers who will then be responsible for training regional and branch managers and staff (step 16). In this case, qualified head office managers, in-house trainers, flying squad members, and outside experts as necessary, will need to become the trainers of the trainers.

This assorted group must learn to teach the MFI's new concepts, operations, and experiences to the people selected to train the regional and branch office managers and staff during the rollout phase. This training

of trainers should take about a month, with the first half conducted at the head office. The second half of the training is best carried out in one of the regions where the MFI operates. The entire group of trainers and trainees should participate in a training session in the region selected. This will enable them to gain experience in training regional and branch staff in the area, and to resolve training issues and problems while they are still together. And head office managers can see for themselves how each trainer functions.

As part of the savings training program, a casebook needs to be prepared for use in various kinds of training sessions. The casebook contains examples of how savings was mobilized from different kinds of savers in the MFI's pilot branches. It highlights the methods for contacting potential savers, the questions they had, the answers given, the problems encountered by the branch, the solutions found, the mistakes made (and how these might be avoided in the future). The cases demonstrate various ways that savers use different kinds of savings accounts and how they customize account use to fit their particular needs. They explore the reasons that households save, and provide lessons in how to explain the MFI's savings products in ways that make them attractive to households. The casebook also focuses on how the pilot project branches mobilized larger savings accounts from both non-poor individuals and local corporations, associations, and institutions.[17] Useful at all levels of training, the casebook is used later also for in-depth work with the regional and branch staff during the rollout training (step 16).

When the training of the trainers is complete, the MFI is ready to expand gradually to all its branches.

Watch out for:

- *Inadequate training of the trainers. This is common and can cause problems as soon as the expansion gets underway.*
- *Weak spots and misunderstandings (or even hostility) on the part of some participants, a not uncommon occurrence. Not all senior managers necessarily support fully the MFI's new products and activities. This training session is a good time to spot any holdouts.*
- *Unrealistic expectations about the time needed for the rollout and subsequent followup and troubleshooting.*

16. Expand gradually to all branches, training managers and staff in each location. Do not rush this step!

Expansion should now take place gradually to all regions covered by the MFI, with several trainers working in a region for about a month on average (see Box 4 for an example of what can happen if this step is rushed). Then the trainers move on to another region. If there are enough trainers, expansion can take place in several regions simultaneously. However, it is better to use a smaller number of highly qualified and experienced trainers and have them move from region to region, than to try to cover many regions at once with less-qualified trainers.

During the rollout process, branch managers and staff must be trained to identify and interview potential savers. They need to be taught to match the MFI's products and services to the clients' varied savings purposes. And they will need training in how to collect different kinds of savings, and how to develop customer loyalty. The trainers should make a special effort to elicit and discuss ideas from the branch staff, who have the advantage of knowing the area. Specialized training is also carried out on operations for different groups, focused on the specific responsibilities of internal supervisors, branch managers, credit officers, cashiers, etc. In addition, the trainers can help the branches with the specific preparations and logistics involved in introducing their new savings products.

[17]See Robinson (2002a, chapter 13) for a detailed discussion of the casebook developed by BRI's unit desa system for training its trainers and managers, as its savings program expanded from the pilot project stage to expansion to all units. Examples used in that casebook included funds mobilized by the pilot branches from a large variety of organizations and institutions: 32 schools, 6 village associations, 20 government offices, 11 cooperatives, 6 agricultural estate companies and 25 local groups (including the Armed Forces Pension Association, the Bus Terminal Employees Association, the Tea Factory Drivers' Welfare Group and various women's, sports, and religious groups).

Box 4

Some dangers of rushing the sequencing: An example

The General Manager of a transformed MFI (a real, if unnamed, regulated institution) decided to expand rapidly from the MFI's quite successful second pilot project to an immediate rollout of the new savings products in all the MFI's branches. Despite considerable advice to the contrary from several international experts, this manager learned about sequencing the hard way. Systems were not ready, staff members were insufficiently trained, and logistical problems were still severe when the bank's promotional campaign went into effect, advertising the availability of voluntary savings products at all the MFI's branches.

When the savings program opened, savers found long lines, harried staff, and disgruntled fellow customers. I talked with a saver who was standing in a long line at her local branch. She was waiting to make a withdrawal from her passbook savings account which she had opened when the savings program was introduced several weeks before. While waiting, she told me that today would be the third time that she had tried to withdraw funds from her account. On the other two occasions, she had not been successful because the computer had been down. She said that this time if she could not withdraw funds, she would close her account.

I stayed with her to see what would happen. As she got to the window, she presented her bankbook and withdrawal slip. However, the cashier was again unable to access her computer file. Finally the exasperated customer said, "I would like to close my account." The cashier went away and came back a few minutes later with the manager, who said, "I am very sorry, but you cannot close your account now because the computer is not working!"

That MFI suffered a serious setback in its savings efforts because it moved too quickly at the rollout stage. It could not handle adequately both its growing loan portfolio and the problems that developed rapidly on the savings side. The loan portfolio declined sharply. Then staff had to concentrate on loan collection—and savings stagnated just when client interest had been aroused. The MFI later got back on track after a long period, but with many unnecessary difficulties. This is an example not to be followed!

This step must not be rushed. When the trainers leave, branch managers and staff need to be well experienced in the various aspects of voluntary savings mobilization and financial intermediation, and able to run their branch operations. Frequent visits by head office managers (and regional office managers where relevant) to all branches are necessary, both during the training and after the trainers have left—so that problems and misunderstandings can be caught early. If certain branches have particular problems after the trainers have finished, the flying squad can be sent in to help. A large institution with adequate management resources should be able to roll out gradually and safely to all its branches in about three to four months. Smaller institutions may be able to have their new savings program available in all branches in two months of rollout.

Thus if everything has gone reasonably well, the time between the start of the first pilot (step 10) and the end of the rollout to all branches (step 16) can be about 18 – 20 months for MFIs of medium and large size, assuming that the management and financial resources needed have been available throughout, and that there have been no major external deterrents (see Box 5).

This includes the first pilot of six months plus time for evaluation and planning for the second pilot; and the second pilot of six months plus the time for evaluation, planning, and training for the rollout; as well as the rollout itself. However, this process can take a shorter time, especially for some small MFIs. It can also take a longer time for larger, more complex institutions, as well as for MFIs that encounter especially difficult problems along the way.

The estimated 18-20 months *does not* include the time for initial capacity development of the MFI, demand research, and product design and preparation for the first pilot (steps 1-9) —all of which can be carried out before the license to take public deposits is granted. Steps 1 to 9 can take a year or more, but the timing depends on a variety of factors, including how far along the MFI is at the start and the quality and time of the management resources provided for the preparation.

Thus, except for small institutions, most MFIs should estimate about a year of preparation before the first pilot project begins, and some 18 to 20 months before the tested savings products are available at all branches.

> ***Watch out for:*** *The most serious (and most likely) problem is that the board or CEO tries to cut the rollout process short. This is a common tendency that can have very serious consequences, not only for savings but also for the quality of the loan portfolio and for staff morale (see Box 4). There are* ***no*** *good reasons to cut short the necessarily lengthy process of introducing savings mobilization on a solid foundation.*

Box 5

Estimates of approximate times needed from the start of the first savings pilot project (step 10) to the completion of the rollout to all branches (step 16) for MFIs of medium and large size

Indicator	Step 10	Step 11	Steps 12&13	Step 14	Step 15	Step 16
	Implement first pilot	Assess results and revise as needed	Plan second pilot and conduct training for second pilot	Implement and evaluate second pilot ; revise and plan for rollout	Train managers and trainers for rollout	Roll out gradually to all branches, training in each region
Estimated time (months)*	6	1	1	Implementation: 5 Evaluation and rollout planning 2	1	2-4 months (depending on institutional size)
Total (months)	6	1	1	7	1	18-20

*Note: The timing estimated here is just a very general guide. It simply indicates possible times for these steps to be carried out appropriately in MFIs of medium and large size. These time estimates assume adequate financial and management resources and no major external deterrents. Small institutions may need less time, while very large institutions may need more time. As discussed in the text, other factors can also influence the time needed. *The crucial point is not to move to the next step until the current step is working well!*

17. To penetrate the market, develop a detailed, systematic approach to identifying potential savers and mobilizing their savings

When all the branches of an MFI have begun mobilizing savings from the public, there is a tendency to think that the hard work is over. Not so! To achieve market penetration, several crucial steps remain.

Designing and pricing products, training managers and staff, and solving the logistical and management problems of expansion are necessary, but insufficient, conditions for penetrating the market. After the roll-out, typically most of the savings is mobilized from the areas nearest the branch or sub-branch, with much of the service area left unserved. Also, the MFI is likely to find after the rollout that some branches have mobilized funds from schools but not from government offices, while others have accounts from government offices but not from schools. Meanwhile, some branches have accounts from traders and businesses but not from organizations or institutions, while others have mobilized savings from religious institutions but not from schools, and from government offices but not from local private businesses.

What is now required is a systematic approach to savings mobilization throughout the service area of each branch. This phase of expansion uses a coordinated and systematic approach to funds mobilization. The approach builds on the methods of locating and estimating savings potential that were developed in the pilot projects and recorded in the casebook. But the focus now is on contacting large numbers of potential savers. Therefore emphasis is placed on training managers and staff in systematically identifying potential savers and collecting their savings (step 18). There is also a strong focus at this stage in reviewing and updating staff incentives in ways that will encourage staff to follow through in contacting potential savers and in mobilizing their savings (step 19).[18]

This method of systematic expansion must first be worked out in a pilot project conducted in the branches of one region. After it has proven successful, it should be rolled out to the other regions served by the MFI.

Watch out for:

- *Fatigue. Managers and staff have been through long periods of intense activity at this point, with savings adding considerably to their previous workloads. Starting a major new systematic effort to penetrate the market is not likely to generate great enthusiasm in the regions. Encouragement and appropriate incentives and training are crucial This is particularly important as by this time, the best people are likely to be receiving offers from other MFIs.*
- *Inadequate coordination. This activity requires high-level management and coordination. If the methodology, the training, and the incentives are not carefully coordinated, the market penetration pilot will not work well and the necessary experience for its rollout will not have been gained.*

18. Select a pilot branch, train the managers and staff, and conduct a pilot project in market penetration

Potential savers are identified and contacted systematically, with the aim of mobilizing their savings and maintaining them as clients. At this stage, MFIs that want to mobilize savings quickly can train branch staff to identify a number (say,100) of the largest potential savers in their service areas—including individuals, organizations, and institutions. The idea is not to mobilize savings only from those with potentially large accounts, but rather to test the systematic approach on larger savers first so that the portfolio can be financed from savings safely as quickly as possible. Once developed and tested, the methods can be used to locate potential savers of all kinds, both large and small. MFIs that do not need to finance their portfolios so quickly can use a cross-section of the population for their systematic contacts.

[18]See Robinson 2002b, chapter 13, for discussion of the way the sequencing for market penetration was done at Indonesia's BRI.

In both cases, potential savers are identified through planned visits to subdistrict, village, or urban neighborhood officials, heads of local institutions and government offices, local organizations, informal leaders, and other community contacts who are interviewed. From these interviews, the branch draws up lists of potential savers and marks their location on a large-scale map of the area. In each branch or sub-branch, a schedule is drawn up showing the staff members who are to visit particular potential savers on particular dates. And a draft manual of these methods is prepared.

Managers and staff must be trained in how to conduct these interviews – both those with local officials and leaders and those with potential savers. They should be taught how to explain the uses and advantages of each type of savings instrument. And they should be trained to keep records of their visits and of any followup actions required. Most of the interviews of potentially large savers are done by regional, branch, and sub-branch managers, credit officers, and other staff who normally carry out field-related operations.[19]

These interviews are also important for gaining information about other local savings sources in the area, such as businesses, schools, government offices, and associations. Staff need to be trained both to look for potential sources of savings that are found almost everywhere (schools, religious institutions, cooperatives, and the like), and to identify sources of savings that are particular to their area (tea estates, silver mines, garment factories, tourist attractions, and so forth). The casebook is useful for prompting questions in interviews, such as: “Are there people in this area who have seasonal incomes? “What kinds of work do they do?“ “Are there people here who receive regular remittances?” “How do they receive their remittances?” “Does it take a long time?” And so on.

If well managed and coordinated, staff who have already been through the previous training sessions on savings can learn relatively easily to locate savers and mobilize savings. But their follow-through in visiting savers tends to drop off when the training is finished and the trainers leave. The staff have learned that visiting potential savers, especially in dispersed areas, is hard work. Appropriate and attractive incentives must be provided. As in the earlier pilots, incentives should not be provided for savings alone but should be installed as part of an ongoing incentive program for high performance in profitability, portfolio quality, number of clients, and volume of loans and savings. Rewards should be provided to all staff of the lowest level MFI units that meet their goals. And rewards should be both in cash and in institutional recognition.

> ***Watch out for:*** *The main problem that is likely to arise here is insufficient incentives for management and staff. Some boards and CEOs may object to staff incentives that are sufficiently attractive to produce the desired performance level. But market penetration is crucial, and staff incentives are essential to achieving it. There are also other potential difficulties. Some branch managers and staff may be uncomfortable introducing themselves and talking with wealthier savers. This requires training and practice. Finally, the systematic approach to savings mobilization is highly sensitive to branch leadership. If a dynamic branch manager understands the importance of the approach and coordinates the activities well, the branch can capture savings quickly. But a branch with an uninterested, unmotivated manager is unlikely to do well.*

19. Revise methods as needed and gradually introduce the systematic approach to market penetration in all branches

The methods, training, and operations of the systematic approach to identifying potential savers and mobilizing their savings can now be revised as necessary and gradually introduced to all branches. The draft market penetration manual should be revised and, as in the earlier rollout, the expansion should be carried out with sufficient trainers in each region to work closely with the regional managers and staff. The presence of the trainers in the branches also represents an opportunity for troubleshooting any other problems that

[19]However bookkeepers, cashiers, guards, cleaning staff, and others can also be trained to conduct interviews on savings demand with local potential savers, especially with friends, family, and neighbors.

may have developed. In cases of serious problems in particular branches, the flying squad can be used as well.

This is the stage of the systematic approach to market penetration at which the MFI begins to mobilize large amounts of savings. Such matters as security precautions, internal controls, asset-liability management, transfer pricing, liquidity management, and cash management all need to be carefully reviewed and improved where necessary.

The previous steps in the sequence were all necessary. But without a systematic approach, market penetration tends to move slowly (allowing competition to move in). But with this methodology, substantial market penetration can be achieved within a few years. It is this step that ultimately makes it possible for an MFI to achieve widespread outreach through large-scale financial intermediation.

> ***Watch out for:*** *Security, fraud, and management problems, as the value of the MFI's savings grows. Also at this final rollout stage, performance is highly sensitive to incentives, and to the quality of the trainers, the branch leadership, and coordination by the head office.*

20. Develop appropriate strategies for investing excess liquidity

As market penetration increases, savings is likely to overtake lending. The number of savings accounts will probably exceed the number of outstanding loans within a few years, and eventually the volume of savings may also be larger than the amount of the outstanding loan portfolio. This assumes that the institution continues to serve low-income and lower-middle income borrowers (as well as others, in some cases), and that it collects savings from all available savers.

But before the amount of savings overtakes that of outstanding loans, it is crucial that the MFI develops appropriate strategies for investing excess liquidity. Reaching the pot of gold at the end of the rainbow is not the end of the road—these funds have to be lent out or invested (usually both). Loans to creditworthy low- and lower-middle–income borrowers should increase, and any remaining funds should be well invested. However, the latter is often easier said than done. Legal regulations and profitable opportunities vary considerably by country and by type of MFI. But as each MFI approaches this stage of the savings mobilization process, its board should consider its investment options carefully. Some MFIs invest in Treasury Bills. Some deposit funds in the interbank money market. Some keep fixed deposits in banks. And some have other forms of investments, including investing in MCIs located outside their service areas. Some combine several of these strategies, and some use all of them.

But in the microfinance industry, little has been done so far in studying or teaching 'best practices' for investing MFIs' excess savings. This gap needs to be addressed, as the number of institutions providing microfinance that have more savings than funds in loans outstanding is growing steadily as the commercial microfinance industry develops. Increasing attention should be paid to identifying suitable options for investing excess liquidity, and to disseminating information about the relative advantages and disadvantages of different options under varying conditions.

> ***Watch out for:***
>
> - *Boards and CEOs that are unqualified to choose investments.*
> - *MFIs that begin to lose mission, depositing their funds in banks rather than lending them out to new creditworthy borrowers who demand loans. When governments set Treasury Bill interest rates, they should realize that very high rates encourage this undesirable outcome.*
> - *Governments that use the savings of state-owned MFIs for their own purposes (for example, savings in state-owned institutions that are used to finance the government budget or lent out in politically-related large loans with poor repayment records).*
> - *Insufficient central bank or bank superintency oversight.*

Using this kind of sequencing process, financial institutions can move in 20 steps or fewer from being donor-dependent microcredit providers to becoming self-sufficient financial intermediaries that serve large numbers of low- and lower-middle-income clients, and that finance their loans with public savings. If the sequencing is carried out appropriately, these institutions can meet large-scale demand from savers, substantially expand their loan portfolios, and accumulate and invest excess liquidity. As noted, not all institutions need all these steps. But all should understand the underlying principles, the reasons for the sequence of steps, and all should heed the warning signals. Christopher P. A. Bennett, who has extensive knowledge of microfinance, once commented to me, "It is not difficult to carry out commercial microfinance well." Then he paused and added, "But it is also not difficult to carry it out badly." For those building financial intermediaries, sequencing makes a difference.

V. WHO BENEFITS?

What does accomplishing all these steps achieve?[20] Who benefits from these painstakingly created commercial microfinance providers? What difference does it make to have commercial financial intermediaries that fund loans with public savings and serve large numbers of low-and lower-middle-income households? The short answer is that commercial microfinance makes a difference—and it benefits just about everyone involved.

Microfinance does not end poverty. For that, many other tools are needed as well. But commercial microfinance increases the options and the self-confidence of large numbers of poor households by providing them with a set of financial instruments—savings, credit, and other products. These products are designed and implemented so that clients can customize their use in ways that meet their own particular needs. This approach helps such people to expand and diversify their enterprises and decrease risks, to store their excess liquidity safely and obtain returns on their savings, and to hold savings accounts that are legally recognized assets. Often the quality of their lives gradually improves. Women develop enterprises, hold savings in their own names, contribute to the household economy—and gain in experience and confidence. Children are sent to school, and child labor may decrease. Housing and health improve. And some of those who expand their economic activities create jobs for others, providing employment to some of the extremely poor.

Different kinds of institutions providing commercial microfinance services have been able to grow to scale profitably and to become viable for the long term. Some have become large-scale industry leaders. As competition develops, some MFIs fall behind or fail, but others gain market share. And with competition, efficiency increases—benefiting both the clients and their financial institutions.

Governments benefit because they no longer need to provide credit subsidies or cover the losses of subsidized credit programs—and because the resulting savings can be used as needed for direct poverty alleviation programs for the extremely poor.

Economies benefit from the increased production, from the new resources made available for investment, and from improvements in equity.

And the commercial banking sector, which is slowly beginning to enter the market, is starting to realize that commercial microfinance represents a very large and profitable opportunity in developing country markets around the world—from which it, too, could benefit. Much of the future of microfinance lies here.

[20]This section is adapted from Robinson 2001.

Appendix 1

Sequencing the introduction of public savings in a regulated bank established by an NGO: Asociación Dominicana para el Desarrollo de la Mujer (ADOPEM)

ADOPEM, the NGO: Background information

The second largest MFI in the Dominican Republic (DR), ADOPEM was originally established by a group of professional and business women in 1982 as a not-for-profit non-governmental organization (NGO) under DR law. An affiliate of Women's World Banking (WWB) since the year it was founded, the clients of ADOPEM are mainly low-income women. However, ADOPEM serves a range of clients, providing both group and individual loans. In addition, ADOPEM provides training programs and business development services. With its head office in Santo Domingo, ADOPEM has a network of 12 branches located throughout the DR. In 2001, ADOPEM received an award from the Inter-American Development Bank as the leading microfinance institution in Latin America.

The table below, which uses figures from the ADOPEM ratings of the microfinance rating agency, MicroRate, shows ADOPEM NGO's performance, adjusted for subsidies, loan loss provisioning, and inflation, for June 2001and June 2003. In 2002, the DR had a population of 9 million and a per capita GNP of $2,320. ADOPEM's average loan balance in June 2003 was $191, or 8 percent of 2002 per capita GNP. Its performance in 2003 is particularly noteworthy since a severe financial crisis developed in the DR that year, which continues in 2004. The crisis exposed deep deficiencies in the country's banking regulatory bodies, as well as major problems in the DR government more generally. It triggered a precipitous devaluation of the peso—from 18 pesos to the US dollar to 50 pesos to the US dollar—in one year. And the plunging value of the peso against the dollar eroded nearly 50 percent of ADOPEM's equity.

Yet as the adjusted figures in the table below show, the number of loans has increased since 2001, average account balance is very low, portfolio at risk has remained relatively low (remarkable considering the circumstances in the country), and the real value of assets has grown slightly.

ADOPEM NGO: Adjusted figures, June 2001 and June 2003 (MicroRate)

Indicator	June 2001	June 2003
Total assets (US$ thousands)	11,252	12, 194
Gross loan portfolio (US$ thousands)	8,108	7,597
Number of outstanding loans	22,386	39,717
Average loan balance per client ($US)	$362	191
Portfolio at Risk (Arrears 30-180 days)/Gross loan portfolio (percent)	2.4	3.7
Adjusted Return on Assets (percent)	10.3	0.3
Adjusted Return on Equity (percent)	19.4	0.7

Source: MicroRate

Creating a development bank

In 1999 ADOPEM NGO began the process of transforming to a regulated financial institution, and during the next two years it conducted numerous feasibility studies while preparing to become regulated. But it then appeared as though the process of transformation might be delayed by the regulatory authorities for some time. To shorten the process and obtain a banking license, ADOPEM decided in 2002 to purchase the license and all the shares of Banco de Desarrollo del Valle, S.A., a regulated bank that was then in the process of liquidation. And on 31 March 2003 the Superintendency of Banks approved the purchase. ADOPEM purchased the bank primarily to provide a full range of services to its clients, mobilize public savings, increase outreach, and diversify its funding sources and liability structure. ADOPEM has applied for permission to change the name of the bank to Banco de Ahorro y Crédito ADOPEM, S.A., and will do so when the request is approved. Meanwhile, ADOPEM began its operations as a development bank in 2003 under the bank's old name.

There could hardly have been a more difficult political economy in the DR in which to begin operations in ADOPEM's newly-acquired bank. But having worked since 1999 to become regulated, ADOPEM decided its best option was to proceed with the purchase of the bank in 2003 despite the country's economic crisis. Reasons included the difficulties and uncertain timing in becoming regulated by other means, the importance of having sufficient liquidity to meet demand from its borrowers, and the need to legitimize the savings that had been collected on a voluntary basis from private and institutional investors.

In May 2004, a new DR government was elected and took office in August; its most immediate focus was on stabilization efforts. Inflation began to decrease, and GDP began to grow. The exchange rate, which had fallen to 53 pesos to the US dollar in February 2004, rose to 31.5 pesos to the US dollar on 25 October 2004. But as of October 2004 the economy still has long way to go toward full recovery, and the financial crisis continues.

As of 30 September 2004, ADOPEM's new bank had $1.6 million in 4,984 outstanding loans. Of these 99 percent of the loans and 95 percent of the portfolio are in microenterprise loans (loans up to a maximum amount of about $1,500). The remainder are in small business loans that start at the maximum for the microenterprise loans and provide credit up to about $15,000. About 75 percent of the bank's portfolio is in microenterprise loans that were transferred from the NGO, with about 25 percent of the portfolio representing new loans made by the bank. The amount of overdue loans as of 30 September was reported as $2,558.

As of the same date, the bank had $744,000 in 1,074 savings accounts and certificates of deposit (CDs). There were 109 CDs, which accounted for 94 percent of the total savings (including funds in CDs mobilized originally by the NGO from investors), while 965 passbook savings accounts hold 6 percent of the savings. Adjusted figures for the bank are not yet available. The NGO still continues to operate with most of ADOPEM's portfolio, which has not yet been transferred to the bank. However, it is planned that the entire portfolio will be transferred to the bank, while the NGO will continue with business development activities and with training and workshops for the bank staff.

Sequencing the introduction of public savings in ADOPEM's new bank

It is still too early for a meaningful evaluation of the bank's performance, but its approach to mobilizing savings, which is being supported by several donor agencies and foundations illustrates some of the principles and practices discussed in this paper. In part because of the influence of WWB, ADOPEM's principles and its sequencing in introducing public savings follow the main lines discussed here in Parts III and IV.

This example illustrates the global nature of information transfer in the microfinance industry today. Between 2000 and 2002, I advised WWB on how those of its affiliates that decide to create regulated financial institutions might approach the introduction of savings. Much of the sequencing was originally worked out at BRI in Indonesia in the mid-1980s. When ADOPEM was ready, WWB provided technical assistance to its managers and staff, adapting the practices that had been discussed at WWB to ADOPEM's needs. As indicated below, by late 2004 ADOPEM's bank was at the end of Step 10 in the sequencing discussed above (finishing its first savings pilot project).

As ADOPEM prepared to purchase Banco de Desarrollo del Valle, it also addressed **steps 2 and 3 (reviewing the country environment and its own performance).** While the latter was good, the former was certainly not. But for reasons discussed above, ADOPEM decided to move ahead despite the risks. For **steps 1 and 4 (learning international best practices in savings and obtaining technical assistance),** ADOPEM was assisted by WWB and other international agencies. For **step 5 (research on demand and competition),** ADOPEM, with help from WWB, undertook a market study of both the demand for, and the supply of, savings services suitable for different market niches. Information was collected about clients' savings behavior, product preferences, and ability to save. The results showed that the types of savings mechanisms in use varied by income level, with lower-income people relying primarily on informal savings methods, while higher-income savers tended to use the formal financial system.

The other aspect of the study—concerning the industry generally and ADOPEM's competitors—concluded that in the DR many institutions provide savings facilities, and a wide range of savings options is available. However, the findings also showed that while the savings market is characterized by considerable competition, there appears to be a mismatch between the supply and demand for savings services appropriate for micro- and small enterprises and other low- and lower-middle income people. ADOPEM decided that although mobilizing public savings would be a considerable challenge (especially during the crisis), it would eventually be possible for its new bank to capture a significant volume of savings.

ADOPEM then moved on to **step 6 (product design and pricing for the pilot project).** The results of the market research were used to design the first group of three products to be tested in the pilot project: passbook savings, contractual savings accounts, and CDs with lower minimums than are typical in the DR. Potential clients were asked their views about the terms of the accounts, as well as the bank's policies, delivery mechanisms, and procedures. To achieve an average savings balance that is sufficiently high for profitability, while expanding outreach, the bank decided to market its new savings and deposit accounts to both higher- and lower-income market segments.

Step 7 (creating a checklist for institutional capacity needs) turned out to include a wide variety of items. High priorities included diagnostics of leadership and management gaps, MIS, treasury management, and internal controls; a range of security issues; and design of automatic reporting systems that would provide timely reports to different levels of management at the pilot branch and the head office. New and highly professional management was brought in for financial management, MIS, and savings mobilization. Needed hardware and software were acquired, regulations established, and manuals developed. And as in the earlier stages, WWB provided technical support for the pilot testing and evaluation.

For **step 8 (selection of the pilot branch),** ADOPEM had no choice. Its La Vega branch, about 120 kilometers from ADOPEM's head office in Santo Domingo, was the only branch allowed by DR's regulators to mobilize public savings—as La Vega had been the head office of the bank that ADOPEM acquired. However, this branch fit the main criteria for location of a first pilot project. The pilot branch is located in an area of reasonable stability (as far as this can be assessed in a time of crisis), with a mixed market, substantial population, adequate infrastructure, and a location at an appropriate distance from the head office, enabling frequent visits from senior managers.

Step 9 (preparation for the first pilot project) involved a complex mix of new managers in key positions, and strong emphasis on appropriate training, MIS, and operating procedures. A training manual was developed, and managers and staff at the pilot branch and the head office were trained in considerable detail—in the methods of savings mobilization and financial intermediation, and in operations, MIS, reporting, cost analysis, products and pricing, customer relations, and other aspects of the many changes being tested. A new MIS system was installed in the pilot branch. The new security arrangements, reporting systems, procedures, supplies, etc. were tested before the pilot was opened, and changes made as necessary.

Step 10 (conducting the first pilot project) began in November 2003. The decision to begin savings mobilization in the midst of a major financial and political crisis would be problematic for any institution at this stage of its savings sequence. ADOPEM gives new meaning to the statement in Part III on preconditions for mobilizing public savings: "Judgment calls may be needed concerning the state of the economy and the political context." However, given ADOPEM's needs and the timing issues involved in purchasing the bank, its leaders appear to have made sensible decisions under the difficult circumstances they faced. However, the bank should proceed slowly and carefully in its expansion beyond the first pilot. The normal (and considerable) difficulties of expansion from a pilot to a full rollout are likely to be exacerbated by the DR's financial situation.

To build the confidence of staff and clients involved in the pilot project, and to start with an average account balance high enough for bank profitability, ADOPEM's leaders and the bank's managers contacted people they knew in the area, suggesting that they open CDs at the bank. This worked well, and the early influx of funds from CDs encouraged managers and staff and helped to spread the word that ADOPEM's new bank is a safe, convenient, and friendly place to save. At the same time, the harder work of mobilizing savings from the public began.

As would be expected in any first pilot, the early record was mixed. Savings were collected from both old clients and new ones. But many challenges were quickly recognized. For example, the bank's physical facilities needed improvement. The branch staff, though trained, were not yet sufficiently skilled or comfortable in marketing the new products. And the marketing and promotional materials were found to be inadequate. These and other difficulties were discovered early by close and continual monitoring of the strengths and weaknesses of many aspects of the pilot. Information collected from the pilot has been carefully and regularly analyzed by the management and staff and also by WWB's technical advisors. And the bank's head office, along with WWB, has played a crucial role in followup of the monitoring. Thus further staff training and staff motivation has been made a priority, as has marketing and improvements to the infrastructure.

The next stage, in late 2004 or early the next year, will be **step 11 (evaluation of the pilot).** This is a crucial stage, especially since the first pilot was conducted under such difficult circumstances. As of September 30, the bank had the 109 CDs discussed above. Beyond that, it had fewer than 1,000 passbook accounts totaling just $42,000. No contractual savings accounts were reported. The first pilot may need to be continued for some time to make sure that its mix of products is suitable, their pricing is appropriate, bank staff are well trained, the infrastructure is appropriate, and operations work efficiently. A careful evaluation and prudent decision about the next step—to continue the first pilot or move to the second—will be of particular importance in this case.

Overall, ADOPEM is optimistic about the bank's future in general and its capacity to mobilize savings. The successes thus far are thought to result in some considerable part from the sequencing undertaken in this first half of the process. But the second half of the sequencing is harder. Barring external problems, if the bank carries out the sequencing slowly and carefully, it has the potential to become a model for other transforming NGOs.

Sources: Excerpts from Saiful Islam's "Experiences of ADOPEM in Introducing Voluntary Savings" (2004); ADOPEM data; MicroRate (2001, 2003).

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