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Microsavings: An essential piece of the poverty puzzle

For the past few decades, microcredit has dominated the narrative of microfinance. In a survey conducted by Accion International, respondents in the microfinance industry identified the single-product approach as one of the most significant obstacles for microfinance institutions (MFIs) (Center, 2011, p. 4). Taking on the challenge of expanding beyond microcredit requires MFIs to reevaluate client needs in order to determine what and how new products should be introduced. This paper explores the unmet needs that stem from the financial unpredictability in the lives of the poor, and uses Grameen Bank as a case study to argue that offering microsavings is an effective way to address those needs and potentially generate the economic growth that microcredit alone cannot do.

The poor's earnings are volatile, varying with seasonal changes that affect the type and level of work required (Gates, 2012). The negative effect of income irregularity can be depicted in a decreasing marginal utility of income model, which shows that an unstable income yields lower utility ("Risk," n.d.) (*figure 1)*. Stability can be achieved through consumption smoothing via microsavings.

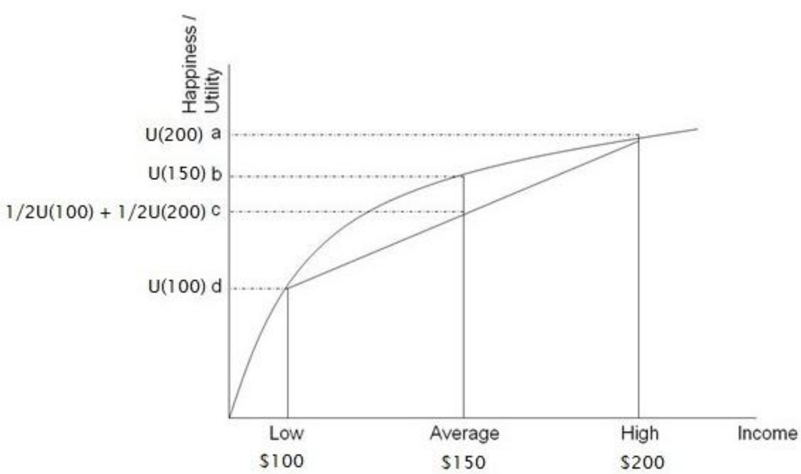

Figure 1: Earning and consuming $200 in one period and $100 in the next yields a lower utility than earning and spending $150 in each period (point c verses point b). Achieving this higher utility level requires consumption smoothing, which is possible through microsavings. By saving $50 of the $200 a worker makes in the first period, she can then add to the $100 she makes in the next period, allowing herself to spend $150 in both periods. This stabilizes her consumption pattern and eliminates uncertainty.

Despite the clear demand for microsavings, the Microfinance Information Exchange found that only 27% of 166 MFIs surveyed offered microsavings products ("A Better Mattress," 2010). Microsavings is an undersupplied service, a missing piece of the poverty puzzle that can increase the utility of the poor.

When MFIs first offered microcredit, many borrowers started using loans as a savings mechanism to meet their demand. Stuart Rutherford, founder of SafeSave, explains this using Grameen as an example: "Customers made a simple calculation: they estimated how much money they could safely pay into this system each week and then calculated the loan size they could afford. Grameen looked at the matter from the opposite perspective: it assumed the loans would be invested in businesses that would produce a stream of revenue out of which the weekly loan repayments could be made" (2001, p.10-11). Grameen assumed that the poor had no capacity to save, and needed to be kick-started with a loan. Thus, they restricted the use of the loan to income generating activities.

This assumption overlooks the reality of the lives of the poor, and reveals the shortcomings of solely using microcredit to fight poverty. The poor have many uses for lump sums beyond investing in income-generating activities, as is evident from their irregular incomes. They often borrow to cover personal emergencies, pay back other loans, and spend beyond daily hand-to-mouth expenditures (Rutherford, 2001, p. 6). Rutherford describes this method of saving as "saving down" (p. 2) *(figure 2)*.

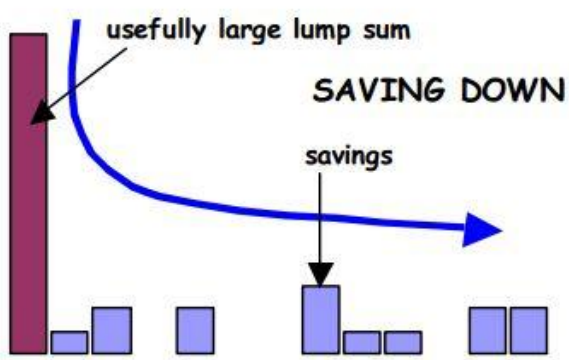

Figure 2: Borrowers take out a lump sum and repay it through a series of savings over time.

Instead of using credit as an insurance or consumption tool, which increases the risk of default, clients should rely on a formal voluntary microsavings service. This “saving up” model allows clients to manage their myriad risks (Rutherford, 2001, p. 2) *(figure 3)*.

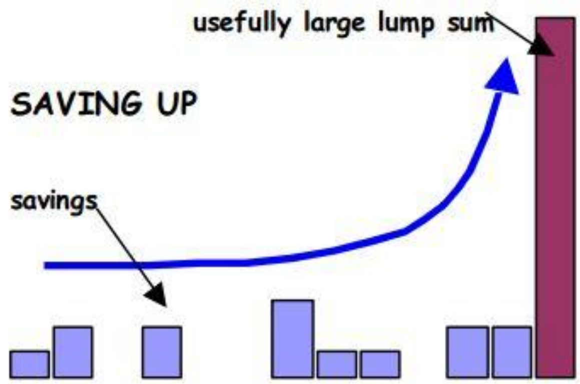

Figure 3: Borrowers gain more security and empowerment when they are able to *build up* a usefully large lump sum rather than *pay down* loans over time.

In 2002 Grameen introduced four new savings deposits, each varying in their purpose, liquidity, minimum required balance, and interest rates. By 2005, Grameen’s savings portfolio had expanded from $146 million to $344 million, and total deposits exceeded the value of loans outstanding. Members opened multiple accounts and stopped treating loans as savings mechanisms with the mindset that saving up was a more optimal way of accessing a lump sum. (Rutherford, “Savings,” p. 40). In addition to consumption smoothing, access to savings deposits like Grameen’s can encourage microenterprise owners to invest in high return projects, thereby growing their business and increasing employment beyond family members – a key driver of economic growth. Under the microcredit model, investing in assets requires taking out a loan under a group liability system, which involves excessive social pressure that makes members choose overly safe investments, and avoid risky but profitable investments (Ray, 1998, p. 581). With access to microsavings, a member is free of this constraint.

From a sustainability perspective, microsavings programs offer clear business advantages for MFIs. Savings accounts provide an inexpensive source of capital for re-lending, and can increase the client base of future borrowers. The latter is especially useful for MFIs that have economies of scale and can generate more profit by expanding membership and loan disbursements without raising on-lending rates (Khandker, Khalily, & Khan, 1995). Finally, savings accounts allow MFIs to obtain information on a client's ability to save, and by implication, their ability to repay loans.

As is the case with any development opportunity, it is important for MFIs to recognize themselves as partners and learners, rather than providers and teachers, when evaluating and addressing client needs. MFIs should aim to learn from the innovative informal savings mechanisms that the poor already use to meet their needs, rather than dismiss them as obsolete. For example, the ROSCA, a community-based savings method, offers members usefully large lump sums in cycles but provides no return (Rutherford, 2001, p. 6-7). Formal microsavings services can improve upon the negative and emulate the positive features of these informal schemes to provide a reliable service that increases choice and minimizes vulnerability. Insisting on dividing the world into dichotomies of us and them, givers and receivers, educated and uneducated creates an empathy gap, and causes well-meaning institutions to single-mindedly do things *to* the poor, rather than *for* the poor. Investor Tom Coleman captures this phenomenon when he writes, "The past ten years' emphasis on MFI institutional profit and success has been great for scaling microfinance but has also corresponded with a lack of attention to client needs and measurable client benefits beyond just repeat business" (Center, 2011, p. 5). MFIs today have the opportunity to return to a more client-centric approach by moving beyond the repeat business of microcredit and expanding into microsavings in a genuine effort to listen to, learn from, and better serve the poor.

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