Microsavings

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Abstract: The demand for micro-savings is high. A vast majority of low-income individuals face saving constraints, however. It is therefore difficult if not impossible for many household-heads to finance investment and smooth consumption via micro-savings. The use of technology opens the scope for removing micro-saving constraints. But this is only possible via unbundling micro-savings from microcrofinance.

Introduction

The high demand for micro-savings is well documented.[2] Low-income household heads, particularly women, often save tiny amounts quite frequently. These savings are often set aside in insecure hiding places, or are entrusted to saving facilitators such as the well-known *susu* collectors who warrant security in exchange of a fee.

Microfinance Institutions (MFIs), on the other hand, offer poor saving facilities to their clients. A vast majority request clients' savings as collateral. Clients cannot withdraw their savings until the end of the loan cycle.

Others offer saving facilities at their weekly or fortnightly meetings with their clients. But many MFIs are not

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[2] See, notably, Armendáriz-Morduch (2010) and Armendáriz (2011)

even lawfully able to collect voluntary savings because of the lack of regulatory frameworks, which often make savings' collection difficult at best, impossible at worst.

One would have hoped that commercialization of microfinance would be accompanied by an increase in micro – savings, because commercial MFIs are regulated financial institutions. This hasn't happened. The commercialization wave has attracted for-profit MFIs. These can access funds, which are comparatively less expensive than micro-savings involving high transaction costs.

Informal venues, such as Rotating Savings and Credit Associations (ROSCAs) and other informal institutions often represent a better alternative to micro-savers, albeit far from those enjoyed by savers in the industrialized world. Can the latest-state-of-the-art technology offer low-income individuals a better deal?

Informal Sources

While informal saving venues are undeniably playing an important role at removing saving constraints, there are problems. Saving constrained ROSCA participants, for example, cannot always borrow on a timely basis, and the amounts they get depend on other participants' contributions.

Moneylenders, on the other hand, offer flexibility. Typically, saving constrained individuals can borrow the needed funds on a timely basis. And early repayments on the borrowed funds circumvent the security problem as moneylenders often get their money back on the same day that return realizations from investments are realized. This

can in turn partially avoid household conflict.[3] However, moneylenders charge astronomically high interest rates.

Family loans can also mitigate saving constraints. Rural – urban migrant family members, in particular, have a higher saving potential because wages in urban areas are higher, and, in many instances migrants are able to open savings accounts in formal-sector financial institutions.

Migrants' savings have been typically transferred to their unbanked family members via financial institutions such as Western Union. Rates on those transfers are relatively high when compared with other alternatives such as the well-known Kenya's M-Pesa transfer system.

Technology

Technology has made it possible for migrants' savings to be transferred to their families via mobile phones. A multiplicity of agents disburse the transferred funds to migrants' families living in remote areas.

M-Pesa in Kenya is the flagship organization using such latest-state-of-the-art technology for making transfers of savings. Over 90 percent of the adult population in Kenya are M-Pesa account holders.

The main puzzle is the following: if relatively well-off family members can transfer savings to their relatives, why can't those relatives living in remote areas save? After all, a saving constrained individual can make transfers to herself under the M-Pesa system. Isn't this a flexible and secure way of saving?

[3] Women, in particular, wish to take home as little as possible for they fear their husbands will take the money away, making debt repayments impossible. See, Baland – Moene (2009).

Practitioners would argue that this proposal offers flexibility: tiny transfers to an individual's own M-Pesa account can be made and withdrawn quite frequently. However, is the system offering security to micro-saving clients?

Practitioners do not think so. An adequate regulatory framework is needed. Without it, individuals' savings cannot be securely handed-in to an M-Pesa agent. This argument raises another puzzle: if technology has made it possible for relatively larger deposits to be entrusted to M-Pesa agents, why would the agents be unworthy of low-income individual's trust for tiny deposits? Are low-income individuals living in remote areas more vulnerable, and M-Pesa collectors more tempted to steal those deposits?

These questions regarding security are undoubtedly important. However, there are no convincing answers yet. Some would argue that we need a Randomized Control Trial (RCT). But critics may object. RCTs are both expensive and context-specific. Alternatively, trial – and –error processes can shed light on such important questions. After all, micro-lending started as a small-scale trial-and-error experiment in a remote village in rural Bangladesh.

To the extent that investment and consumption smoothing need to be financed, micro-credit and micro-savings are often linked. The problem is that practitioners tend to link microfinance with the M-Pesa transfer system. The Musoni MFI in Kenya is an example. But there are many others.

Without underestimating practitioners' efforts in Kenya and elsewhere, I strongly believe that microfinance and M-Pesa are two distinct business models. Microfinance main objective is to remove credit constraints via offering greater micro-credit access. M-Pesa, on the other hand, has opened

the scope for offering enhanced micro-saving access. The two are complementary, but attempting to bundle the two is wrong.

MFIs are uninterested in micro-savings. This is an activity that MFIs do not have expertise in, and that it does not accord well with microfinance self-sustainability objectives.

Another complication when trying to bundle microfinance and M-Pesa is that microfinance is often needing direct contact between credit agents and its clients for trust-building. This might be true for microcredit. Extending loans electronically might increase default rates, particularly in the absence of credit bureaus and adequate hard copy and reliable identification documents. The scope for lowering transaction costs via the use of technology in microfinance is therefore limited.

This is however not true for micro-savings under the M-Pesa system. M-Pesa agents are already being entrusted with relatively large amounts of savings to be disbursed to other M-Pesa clients. If the incidence of fraudulent activity is low for large savings, what makes practitioners think that it would be high for small savings via transfers into low-income individuals' own M-Pesa accounts in remote rural areas?