EUROPEAN
MICROFINANCE
AWARD 2020

Encouraging Effective & Inclusive Savings

- CONCEPT NOTE -

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EUROPEAN MICROFINANCE AWARD 2020

The European Microfinance Award 2020 'Encouraging Effective & Inclusive Savings' highlights the crucial role that savings can play for low-income and excluded populations, and how financial providers can encourage their effective and widespread use.

This Concept Note provides information on the topic of the Award. For instructions on how to apply, please refer to the Application Guidelines available on the Award website.

ABOUT THE AWARD

The European Microfinance Award is a prestigious annual award with €100,000 for the winner and €10,000 for the runners-up, which attracts applications from organisations active in financial services around the world that are innovating in a particular area of financial inclusion. It serves two parallel goals: rewarding excellence, and collecting and disseminating the most relevant practices for replication by others.

The Award was launched in 2005 by the Luxembourg Ministry of Foreign and European Affairs – Directorate for Development Cooperation and Humanitarian Affairs. It is jointly organised by the Ministry, the European Microfinance Platform (e-MFP), and the Inclusive Finance Network Luxembourg (InFiNe.lu), in cooperation with the European Investment Bank (EIB).

The Award is presented in a ceremony which in the past has been in the presence of Her Royal Highness the Grand-Duchess of Luxembourg and the Luxembourg Minister for Development Cooperation and Humanitarian Affairs. The ceremony takes place during the European Microfinance Week in Luxembourg.

Organised by:

LUXEMBOURG AID & DEVELOPMENT

EUROPEAN MICROFINANCE PLATFORM

InFiNe Inclusive Finance Network Luxembourg

Why Savings Matter

We all have a basic understanding of what savings - or the act of saving - are. In its simplest sense, it's an intuitive concept. You hold back some of what you earn, sacrificing immediate pleasures or opportunities for some future benefit. This benefit can vary from coping with the unknown and unplanned shocks that can throw one's life into disarray, to more highly planned savings for high-cost but predictable future expenses - weddings, pregnancy, a deposit for a house, or retirement. In English, in fact, the word 'saving' embodies this dual meaning: you save some of what you have for the future, but that safety-net in the bank can also save your family from a shock that might otherwise push you into destitution.

For much of the past 40 years, the microfinance sector has focused overwhelmingly on credit - from microenterprise loans to consumer and SME finance. Credit is easier to offer and more profitable for the provider. More often than not, that results in credit being provided as the default financial product when other options - savings or insurance in particular - are both better suited to the particular needs of the client, and come at both lower cost and lower risk. And even though for MFIs total deposits are comparable to loans outstanding, the figures conceal the reality of many dormant accounts, with most deposits drawn from higher-income individuals. While this provides flexible, local-currency funding that's cheaper than foreign debt, it does not serve the poor or the excluded. The provision of savings as a service to this population remains consigned to a much smaller segment of markets and institutions, and remains a rarity in the global financial inclusion ecosystem overall - despite the importance of financial inclusion generally (and savings in particular) within several of the Sustainable Development Goals (SDGs), among them SDG 2 (zero hunger), SDG 5 (gender equality) and SDG 8 (decent work and economic growth).

The Many Reasons to Save

There is a growing literature on the benefits of effective and inclusive savings to clients, providers and society at large. Part of this is because of the enormous number of benefits that savings bring to clients:

Consumption smoothing. For all households - but especially those without the security of salaried income, which comprise the majority of the world's poor - variations in income and expenses can be one of the heaviest burdens of poverty. Easily accessible savings are the most affordable and suitable means of absorbing periodically increased expenditures - and have been shown to be an effective substitute for short-term debt. Unfortunately, too often microcredit (and increasingly, digital loans), fills this gap, potentially leading to a risky and costly practice of cycling debt, borrowing from one lender to repay another.

Protection from shocks. Typically, and too often, short-term emergency credit has been the default answer for families who suffer a health-related or other financial shock that leaves them vulnerable to destitution. The shortcomings of borrowing for emergencies are many - high interest rates, delays in getting funds, and sometimes even the need to go to unscrupulous lenders. Insurance can play a key role in mitigating shocks too, but the sunk costs of premiums (which can never be recouped and have indeterminate benefits) is a 'hard sell' to cash-constrained households. But saving for the proverbial 'rainy day' doesn't involve any of those negative consequences. More liquid savings, such as mobile wallets, can even help households better share risks between friends and family.

Long term planning. Besides short-term consumption smoothing and unexpected shocks, there are also large but foreseeable expenses. Many of these are lifecycle events for which savings are perfectly suited and effective, including tuition fees for children or young adults, weddings, childbirth, house purchase/improvement, and eventually retirement. Whether saving small amounts over long periods or setting aside sudden inflows (for example, harvest income), savings help people accumulate usefully large sums to meet these long-term needs.

Gender empowerment. In too many cultures, women lack autonomy over their own finances, and it is common in some countries for husbands to take control of women's cash earnings that they bring back to the household. In other places, where women are the primary money managers in the household, money can still be demanded by spouses and relatives, preventing women from investing in important family needs and from exercising financial independence generally. There is a wealth of research demonstrating the depth of impact that savings has on women's empowerment.

Savings as equity creation. A key aspect of both short- and long-term savings is its value in building equity. Whether saving to buy land or make a meaningful home improvement, send a child to school or vocational training, or buy a long-term asset - these are all ways to increase a household's net worth and improve its financial well-being.

Productive investment. Investing in a business, such as upgrading equipment, hiring more staff, or buying inventory in bulk, incurs significant cost to an entrepreneur, but forgoing this because of lack of capital can involve an opportunity cost as well. Credit is an important way to make this investment - especially when time is a limiting factor - but it is not the only option. Using savings for investment can be a cheaper, less risky and equally effective option - especially for smaller sized investments. And for larger investments, savings can be an important complement to debt, reducing risk to both borrower and lender.

Formalisation. For a low-income household, the ability to move from a purely informal activity into the formal financial sector can bring about significant opportunities. For example, purchasing land with a formal title may require capital that only a larger financial institution can provide. And for a client without formal credit history, savings can be an important step

Women & savings

One of the major values of savings -- and one that too often goes unremarked -- is its many impacts on women's empowerment, especially in many of the countries of the Global South. In developing countries, there is a significant gender gap in formal savings, with men being 6% more likely than women to save formally, according to the 2017 Findex. There is also a persistent lack of formal savings products that meet the specific needs of women. The savings gender gap is as much a problem of access as of suitability.

But to maximise the value of savings, access alone is not enough. Control over savings accounts and how it's exercised is a major factor. When women are able to manage their savings accounts with protected individual access, they increase their financial autonomy and decision-making. That leads to all kinds of household changes, for example increased purchases of productivity-enhancing appliances that typically benefit women, such as washing machines, which free women enormously from back-breaking and time-intensive domestic chores - one of the original cornerstones of women's liberation. In another example, before a factory made the switch from cash to digital payments, women's mothers-in-law sat outside the gate on payday, waiting for their cut; afterwards, employees had their own accounts – and more control over their money.

Groups – collective finance – have always played an outsized role for women. Self-Help Groups have been hugely effective in women's economic empowerment (for savings as well as credit). The VSLA methodology provides another useful lens for savings impact on women -- a study in DRC showed it to be an important channel to increase household income and improve food security, health status or children's access to education. However, another example in Rwanda showed that women's ability to fully participate in and benefit from the VSLA methodology is hampered by gender norms and inequitable power relations with their husbands - further demonstrating the value of savings that are designed with a clear understanding of the full reality of the lives of the women clients they're meant to serve.

Women face specific challenges regarding the most dominant shift in inclusive finance today – the rise of digital financial services (DFS). They value privacy more than men, and have different priorities and needs. Moreover, while DFS facilitates convenient and accessible accounts, it also risks increasing existing gender gaps – for example, women are 10% less likely to own a phone, so leveraging this technology provides comparatively more economic opportunities for men. And finally, empowerment through savings goes beyond household dynamics and gender gaps: mobile savings accounts have even been shown to decrease the use of paid sex as a coping mechanism by vulnerable women in Kenya.

towards building a relationship that can unlock that credit.

Safety and convenience. The most common way to save, especially for small, short-term needs, is the proverbial cash in the mattress. But that comes with risks - theft, fire, typhoon as a few examples - all of which can wipe out hard-earned savings overnight. More commonly still, such cash is subject to 'leakage', with the careful saver coming back to the stash to meet immediate needs, help out a family member or a neighbour, or to succumb to a temptation purchase. Saving in a formal account, especially one that requires some extra effort (even if small) to access, is a motivator - for all people, everywhere.

How 'Real' People Save

Financial decisions are affected by a multitude of variables: long-term calculations, risk avoidance, gut instinct, habits, social pressures, misaligned incentives and misperceptions. Put together, they create savings practices that aren't well aligned with the traditional economic view of people as rational actors, nor are they well matched to traditional savings products like time deposits and current accounts.

Instead, people employ different 'mental models' that help them save better. Many can be seen in the informal sector. One common practice is using different jars for different savings purposes (e.g., one jar might be for an upcoming wedding gift, another for school fees, still another for daily needs). Similarly, a typical ROSCA - a group of friends or colleagues that gather on a regular basis (such as a payday) and put in a fixed contribution into a pile that each member takes home on a rotating basis, repeating the cycle until each person has received the 'payout' - is a way to save by creating an obligation to one's peers. Another particularly common practice is giving cash to a neighbour to safeguard - not because the neighbor's house is more secure, but because it gets cash out of the house, where it can't be spent.

The complex mental models that show up in these informal practices are starting to be better understood and explained by the relatively young area of behavioral economics, which stands in contrast to classical economic theory which always maintained that humans are rational economic actors. Instead, the biases and cognitive limitations which drive behaviour are "human traits that systematically influence individual decisions and market outcomes", according to Nobel Laureate Richard Thaler, and are central to savings choices, among other things.

With few exceptions, the products offered by banks and other deposit-taking institutions do not fit well with the mental models underlying those of typical small-scale savers. However, the few exceptions that do exist - such as prize-linked savings accounts, which avoid telling people to save rather than buy lottery tickets by instead bringing the fun of a lottery into savings - show just how effective savings can be when they match how real people actually think and behave.

More recent examples, designed through behavioral economics research, show similarly promising outcomes. The Save More Tomorrow programme involved prescriptive savings advice, and opt-out models involved switching employees from defined-benefit to defined-contribution plans. The programme found that at least some low-saving households welcome aid in making decisions about their savings. Commitment savings have emerged as an important means for providing savings opportunities that both fit people's mental models and also result in substantially higher levels of saving. Some aspects of this, such as clearly denoting the purpose of the savings (such as for health expenditures) can increase saving activity. Even simpler interventions, such as simple reminders to save, have likewise proved effective in increasing savings.

These are just some examples from a growing research field that reveals how better understanding people's mental models and behaviours means they can be 'nudged' towards positive behaviour - such as planning for the future, managing risk and reducing the inappropriate use of credit.

The Landscape of Savings

The long history of savings can be seen in the highly varied landscape of practices and providers. Among the oldest are the mix of savings and postal banks as well as savings and credit cooperatives scattered around the globe, all of which trace their roots back to 19th Century Europe and were spread globally during the age of colonialism[1]. In part due to that complicated history, this variety of institutions comes with mixed levels of outreach and effectiveness, ranging from stodgy organisations serving mainly government needs to those that actively serve rural and poor households, while continuing to innovate and adapt.

Among traditional MFIs, savings has had a complex history. In countries like Indonesia and Bangladesh, savings were introduced either alongside credit or soon after, and have co-evolved over the decades as an integral part of their financial offering. There and elsewhere, compulsory savings were also often included as part of the credit programme, but not as a stand-alone financial service. However, for many MFIs in the world, more formalised savings came much later, when they transformed into regulated entities with the necessary licenses to collect deposits. But in those cases, such savings more often than not focused on gathering deposits from upper-income customers, while for their target poor and excluded clientele, savings products remain greatly under-utilised.

[1] For further reading on the history of savings, see Due Diligence: An Impertinent Inquiry into Microfinance. David Roodman, CGD, 2012 (Chapter 3: Credit History)

Another model, with roots going back several decades, is a range of client savings groups formed by various local and international NGOs, often modelled on informal groups such as ROSCAs. Such programmes can reach even the poorest households living in remote rural areas. There have also been efforts to link them with formal institutions, whether as a means to securely store the savings, access additional capital as credit, or gain access to insurance.

Finally, the newest form of savings is happening as part of the growth of digital financial services, leveraging the spread of mobile phones to enable mobile savings programmes. There have been cases where clients have leveraged technologies that were never intended as savings vehicles - such as mobile wallets - to store their savings. This is a fast-evolving market that may greatly change the landscape of savings.

The Value of Savings to Financial Services Providers

The benefit of savings extends beyond those clients and their households. There are significant benefits to financial services providers as well. Savings mobilisation can also offer an opportunity for providers to develop new relationships with clients. Providers that offer meaningful savings services to a broad client base can sustain growth and innovation for longer periods than those that do not, because of deposits' higher stability, linkage of institutional growth to clients' preferences and economic trends in the environment, increased customer loyalty to the institution, as well as increased opportunity to cross-sell products like credit to clients they already know well from their savings history.

Savings also offer financial stability. For example, diversifying into local currency deposits can reduce dependence on foreign funding and reduce the risks stemming from exogenous financial and political events. Moreover, when those deposits are further diversified among different population segments, that can further offset liquidity pressures due to seasonal or periodic collective cash needs.

Finally, savings mobilisation is often associated with an inexpensive source of funds for financial institutions. However, when it comes to small savings, the matter is more complex. For institutions collecting deposits from higher-income households, the funds can indeed be cheaper than borrowing from institutional and foreign creditors, particularly due to the added benefit of local currency. However, for those focused on savings as a service to poor households, the cost of delivering those services more or less offsets the benefits of lower capital cost.

The Value of Savings to Communities and Society

The benefits of widespread access to effective and inclusive savings and the formalisation of savings within an economy are not limited to the direct benefits to clients and providers: there are significant benefits that accrue to communities and societies as a whole.

First, a savings culture is part of the development of an 'ownership society', in which citizens can acquire wealth, build assets, and have a personal stake in the prosperity of the environment around them. An 'ownership society' can bring expectations of accountability of the state vis-a-vis the individual, particularly on matters of regulation, transparency, corruption and a more stable financial and economic system overall. This is complemented with growth in the private sector, when formalised savings becomes the norm. New providers enter an (ideally) competitive marketplace, in theory reducing costs, increasing efficiencies, creating jobs and expanding the private sector's role beyond just financial services.

Saving - especially for mitigation of shocks, and health shocks in particular- can also improve health outcomes, enabling treatment in communities where free-at-point-of-service health care is limited or non-existent. When individuals can access health care, there is a knock-on effect on families, communities, and society.

The empowerment of women that comes from enabling their financial autonomy likewise has benefits that radiate out beyond the individual. Outdated prejudices and practices can be replaced by more equitable and progressive gender roles, and the unleashing of women's economic potential in the economy.

Finally, savings - by definition - involves thinking about the future, planning for goals and contingencies ahead. A reduction in impulsivity and risk-taking, replaced by future planning, is positive at the micro and macro levels alike. And households that are able to save for later in life place fewer burdens on the state, freeing funding for projects - transport, education and health infrastructure as examples - that benefit society as a whole.

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