A REINTERPRETATION OF MANDATORY SAVINGS– WITH CONDITIONS...

- PMP's Premium clients are viewing mandatory savings in an unconventional way, bolstered by the relatively liberal withdrawal policies of PMP. The savings has transformed into a usable resource in several different ways, both short- and long-term.
- The case provides an interesting counterpoint to the increasing calls for the exclusive encouragement of voluntary savings products.
- At the same time, confidence is undercut when the funds are appropriated to cover group loan defaults; in this way, MFIs like PMP face a difficult choice between encouraging savings or sustaining their current group-loan methodologies.

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MANDATORY SAVINGS POLICIES are usually seen as a risk-management tool benefiting microfinance institutions, or MFIs, not clients.

A new study by Microfinance Opportunities of clients at a Latin American MFI found that these savings can help both groups, but that the organization undercut confidence in this resource by appropriating the savings to cover loan defaults.

The research suggests that MFIs like Pro Mujer Peru, or PMP, face a difficult choice between encouraging savings and sustaining their current group-loan methodologies.

Microfinance Opportunities' investigation centered on the Premium loan offered by PMP, which helps women become self-supporting through financial opportunities, training and health care. This loan features a longer term, less frequent payments, and lower interest rate than PMP's Regular loan product. The Premium loan follows PMP's group-lending methodology, though the loan groups are considerably smaller than Regular loan groups. The loan is targeted at (and limited to) PMP's longer-term, more successful microentrepreneur borrowers—a bigger loan to meet the needs of bigger borrowers.

AN INTRIGUING INITIAL VISIT AND A FOLLOW-UP

Upon our first visit in November 2008, we found considerable buzz among Premium clients about the savings connected to the loan. PMP requires clients to save money in set percentages (0-20 percent at the start of the loan, depending on loan size and cycle number, with another 10 percent built over the loan term). The accounts offer a very low level of interest—considerably less than commercial banks. But almost unanimously, clients liked it. Rather than viewing it as "the price of borrowing" (Rutherford, 2005, p. 22), clients saw it as a productive way to amass resources over time.

The mandatory nature of the savings, coupled with PMP's relatively liberal policy on withdrawals, was seen as critical. Simply put, these clients like to be forced to save, but also wanted reasonable access to those savings when they needed them, which PMP afforded (see "Ways to Savings" box on next page for explantion of withdrawal policies).

Beyond these PMP accounts, savings behavior was scant—only about one-third of respondents had voluntary savings accounts, and only about 20 percent had voluntary savings accounts with formal financial institutions (the rest saved at home).

The initial observations on savings inspired a follow-up investigation in June 2009, which combined analysis of PMP's managament-information system data with additional client interviews more tightly focused on savings behavior. In the end, we saw support for the utility of PMP's mandatory savings, but also a critical drawback that lay mostly dormant until Peru's economy weakened substantially in early 2009.

CAPITALIZING ON SAVINGS OPPORTUNITIES

Using MIS data for the whole client base, we found that 80 percent of Premium clients were saving more than necessary in these accounts, as compared with 56 percent of borrowers of PMP's Regular loan. As indicated in Table 1, the amount of "surplus" savings was not uniformly high. However, the average amount—$59—is by no means insignificant in Puneño household budgets. That amount might function well as an emergency reserve. And we see from the "High Excess" amounts that there were subpopulations saving considerably more. For example, in the three upper loan-amount brackets, 16 percent of borrowers had at least 50 percent more on deposit than they needed at disbursement.

In-depth interviews with clients confirmed that a clear majority viewed the mandatory savings policy in a positive light, for two major reasons:

Clients repeatedly attested that saving any other way is difficult for them. They noted the many claims on their funds they face, especially from within their families. Moreover, saving with PMP was seen as relatively painless—they barely noticed the extra cost spread among their loan payments.

In addition, clients spoke of considerable distrust of commercial financial institutions. This is likely a product of the clients' relative inexperience with these institutions. Clients repeatedly asserted that banks

TABLE 1 - AVERAGE & HIGH EXCESS SAVINGS, PREMIUM CLIENTS

LOAN RANGE IN USD	AVERAGE EXCESS SAVINGS	AVERAGE EXCESS SAVINGS IN USD	HIGH EXCESS SAVINGS	HIGH EXCESS SAVINGS IN USD	PERCENTAGE OF LOANS AT EACH LEVEL
$1,367+	6%	$98	16%	$273	12%
$1,033-1,333	5%	$60	10%	$120	7%
$867-1,000	5%	$51	16%	$164	19%
$700-833	7%	$57	60%	$513	62%
ALL	7%	$59			

require high minimum balances and charge substantial fees when the balance is not maintained, which is not universally true, but the belief was widespread. This attitude also undoubtedly derives from the checkered history of banks in Peru. "Banks disappear!" said one client.

In terms of use patterns, many withdrew the total allowable amount after each loan (option #1 at right); here, use tended to be routine household expenses. In these scenarios, with quick cycles of savings accumulation and withdrawal, the mandatory savings mechanism can be seen as a cash storage scheme. These clients are constantly borrowing and so they are constantly building these sums, which pay off in a predictable, periodic inflow of cash, almost like another loan, except that it is paid off.

Among the clients who tended to let their savings sums build into a surplus over several cycles (option #2 at right), areas of use tended to be more substantial. Some made investments in their businesses. Others used the withdrawals for lump-sum life-cycle expenses like family celebrations or school tuition.

None of the clients interviewed had withdrawn all of her savings with PMP because of a sudden need for cash (option #3 at right). But many said they view the balance as a legitimate resource in this regard and would use it in an emergency.

A final pattern was to defer withdrawals entirely (option #4 at right). Here the savings can quickly become a substantial reserve resource. PMP policy encourages borrowers to wait until the end of a loan cycle to withdraw this "surplus" savings build-up. However, a client can always submit a special request to her group to receive the withdrawal in the midst of a cycle, making it a fairly liquid resource in case of an emergency.

The flexibility to choose the timing of the withdrawal—immediate or deferred—derives in part because these women were relatively successful. Their resources tended to be diversified, so they could afford to let their PMP savings sit until they needed it.

BUT HERE'S THE RUB…

The interviews also revealed a serious drawback to strategic use of the obligatory savings as a financial resource. As part of the group-loan methodology at PMP and MFIs around the world, these savings balances can be appropriated by the institution to compensate for group members who are having trouble making payments.

Payment problems can develop within a group at any time, but they are especially likely in a weakened economy. This point was driven home by comparing the experience of interviewees in the supplemental visit in June 2009 against that in November 2008. Peru ended 2008 with a fairly robust economy, with inflation balanced by strong economic growth (INEI, 2009). However, the first half of 2009 brought the global recession to Peru's doorstep, if default rates are any indication.[1]

WAYS TO SAVINGS (& WITHDRAWALS) WITH THE PREMIUM LOAN

Imagine a Premium client who takes out her first three Premium loans in the following amounts: $830, $950, and $1,030 (figures not far from the program's average amounts for the first three loans). Following the policies of PMP, for the first loan, she would not have to have anything on deposit. She accumulates 10 percent or $83 over the course of that loan, which she cannot withdraw unless she drops out of the program at the end. She does not drop out, instead taking out $950 in the next cycle. First of all, she will need to come up with $12 to make the 10 percent of $95 needed on deposit for that second loan. Then, over the course of the loan, she builds another 10 percent or $95. She continues on to the next cycle with a loan of $1,030 loan. She starts with $190 in savings and builds another $103 over the loan term, for a total of $293.

In other words:

	Up Front	Over Term	Total Savings
1st Loan	0	$83	$83
2nd Loan	$95	$95	$190
3rd Loan	$103	$103	$293

Options for withdrawals:

1) At the end of the 2nd term, she can withdraw $87 with no disruption in this borrowing sequence.

OR

2) At the end of the 3rd term she can withdraw $190, while continuing to seek up to $1,030 in the fourth borrowing cycle.

OR

3) She can take the more drastic step of withdrawing all of the $293 at the end of the 3rd term. The immediate consequence is that she would be ruled out of at least one subsequent borrowing cycle (though free to resume after that, whenever she could restore the necessary up-front sum).

OR

4) She can let the $293 ride, continuing to borrow and accumulate savings until a serious need arises.

[1] Officially, Peru's national economy did not begin to contract until the third quarter of 2009 (INEI, 2009). Research turned up anecdotal evidence to suggest that the Puno region suffered disproportionately in this downturn, which may explain the early effects observed there. Macroeconomic indicators for the Puno region were unavailable at the time of printing.

The pitfalls of this situation were illustrated particularly well by two interviewees. Both had considerable surplus in their accounts, and definite plans to use those funds. One became seriously ill in December 2008 and wanted to withdraw all of her savings to offset the bills. The other intended to use her accumulated savings as a capital infusion for her growing home-based fruit juice business.

In both cases, other members of the loan groups were unable to make payments in recent months. As a result, PMP took control of the group's savings deposits to cover for the imperiled borrowers. This scenario is part of PMP's group lending methodology, undoubtedly stipulated in the contracts clients sign. But neither of these clients seemed prepared for it.

The two clients noted that because they were the biggest savers within their group, they suffered disproportionately when the group's financial health soured. "The group guarantee is great when things work in the group, but it can come back to hurt you later," explained one.

THE PREMIUM SAVINGS CASE IN PERSPECTIVE

For those interested in expanding access to microsavings, the findings of this investigation provide tantalizing evidence of a potential reinterpretation of mandatory savings. At least for relatively successful borrowers, mandatory savings seems to have evolved into a fairly flexible resource with real risk-management potential. Its function and use invite comparison to many commitment savings products (cf. Ashraf, et al., 2003), and its potential for offsetting economic shocks is precisely what leading scholars have posited as the core value of microfinance (e.g. Sebstad and Cohen, 2001). A twist is that mandatory savings is usually seen as helping institutions manage risk, rather than helping clients manage risk. Here it functions both ways.

The mandatory savings policy also built savings in a way that no other person or circumstance could challenge—there was simply no choice in order to have the loan. Moreover, it was not available for withdrawal in its entirety at all times, which could help clients deflect at least some claims on it. In other words, there was some illiquidity to these accounts, and that could be an advantage.

To some extent, these findings challenge the arguments of microfinance scholars (cf. Rutherford 2005; Hirschland 2005; Churchill, et al. 2002; Robinson 2001; Robinson 2006) on the virtues of voluntary savings over mandatory. The arguments have tended to center around the idea that mandatory savings are not accessible or flexible enough to serve client needs for lump sums. For these clients, PMP's mandatory savings are indeed flexible enough, and voluntary savings remains unappealing and/or impractical. These findings also run counter to some critiques of the village-banking model, which have characterized forced savings as a hindrance to the proliferation of credit (e.g. Westley, 2004). If anything, this client group wants *more* obligatory savings.

But the whole concept hinges on the solvency of the group. It is derailed when the group's financial fortunes suffer. That has seldom happened in the recent history of PMP, but the threat is always there.

FIGURE 1 -AN INTERVIEWEE & PREMIUM CLIENT IN TACNA

Hence the utility of the obligatory savings remains conditional, potentially forcing MFIs to choose between encouraging savings and sustaining their current group-loan methodologies.

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