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# Does Microfinance Institution Has Institutional Properties to Generate Savings?

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## Abstract

**Purpose** - Microfinance institutions (MFIs) in Bangladesh have been providing savings services to their clients at least for the past 15 years. However, whether an MFI should have institutional requirement(s) to be a deposit-taker generates interest among academics and policy makers. Thus, this short note aims to provide a brief overview of institutional properties of MFIs.

**Research Design, Data, and Methodology** - This study used the existing literature and reports by the Microcredit Regulatory Authority' to investigate institutional properties of MFIs. In doing so, we have used 'institutional theory of saving' as a theoretical ground. Although the 'institutional theory of saving' has several important properties, the existing literature mostly discusses seven features such as information, incentives, facilitation, expectation, access, restrictions and security.

**Results** - It is found that MFIs— in general— should have all the seven important institutional properties to be considered as an ideal savings institution. With regards to the microfinance sector in Bangladesh, this study supports that all the NGO-MFIs have these properties to be considered as an ideal deposit taker.

**Conclusions** - The microfinance sector in Bangladesh needs to design and develop comprehensive and customer friendly savings products to further motivate the poor to save in MFIs.

**Keywords:** Microfinance Institutions, Saving, Institutional Theory of Saving, Bangladesh.

**JEL Classifications:** D14, I31, G21.

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## 1. Introduction

Nobel laureate Professor Muhammad Yunus started the concept of microcredit in 1976 in Bangladesh. The concept expanded over a hundred countries within a short span of time accounting for more than 150 million of clients worldwide and 35 million of clients in Bangladesh alone (Mia, 2016). Generally, providing credit to the unbanked poor is one of the ways to battle poverty, however, it is not a 'panacea' or a 'silver bullet'. However, providing savings facilities could be one of the best anti-poverty intervention for poorest of the poor, which could be used to generate additional income through investment (Dowla & Alamgir, 2003). That

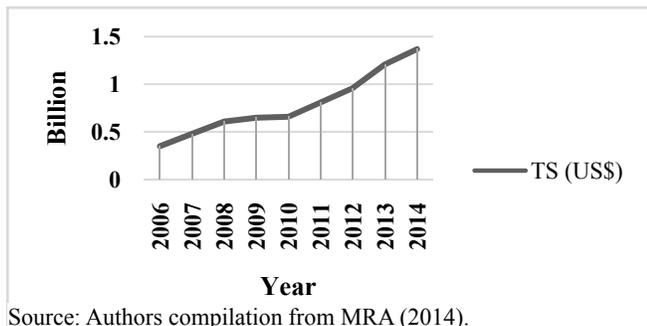
is why; credit and savings are both complementary to each other and showed to have a significant impact in combating poverty and enhancing socio-economic development of the poor. It is also argued that savings services could be more important than normal credit (Robinson, 2001). The MFIs in Bangladesh aggregately generated almost 1.4 billion of total savings (TS) in 2014. Figure 1 shows the trend of total amount of savings in the microfinance sector in Bangladesh from 2006 to 2014.

Moreover, poor families should save not only to be eligible for paying the debt but also to use as a reserve for their future precautionary expenses (Sherraden & Barr, 2006). Apart from that, savings can also work as a stabilizer for smoothening the consumption and expenditure at the time of financial turmoil/shocks. In this context, microfinance institutions (MFIs) are playing an important role in providing various savings services for the unbanked poor. Despite the initiation of savings services by MFIs around 15 years ago, whether they have capabilities or properties to provide sav-

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Source: Authors compilation from MRA (2014).

**<Figure 1>** Amounts of total savings in the microfinance sector in Bangladesh (2006-2014)

ings services to the poor due to its informality of nature has not been thoroughly discussed. The aim of this short note is to answer this question from institutional perspective by using the lens of the ‘institutional theory of saving’.

Savings has been explained by three major perspectives/ theories, such as individual, social stratification and institutional (Sherraden & Barr, 2006). It has been greatly acknowledged that all of them have a significant impact on shaping the savings behavior of individuals or households’, albeit there are some differences on the magnitude and impact. The individual perspective basically includes the neoclassical views of permanent income hypothesis, economic psychology and behavioral economics. While the social stratification theory supports the intergenerational linkage among the individual and families that maintain and transmit social and economic status from one generation to another (Bowles & Gintis, 2001; Han & Sherraden, 2009).

The institutional theory of saving — the focal point of this note — postulates that apart from other socio-economic and individual factors; institutional factors may influence savings behavior of low income families (Beverly & Sherraden, 1999). It means that availability and accessibility to the financial institutions can motivate individual to save. However, there are several important elements in the institutional saving theory for a financial institution to be considered as a deposit taker. Despite several others, seven are discussed more frequently in the literature; namely, information, incentives, facilitation, expectation, access, restrictions, and security. Whether an MFI should have all these components to be called an ideal savings institution is quite vital to understand the interaction between individuals and institutions in determining the savings behavior of the poor. The following section provides a brief discussion on these seven institutional properties based on the scenario of the microfinance sector in Bangladesh.

## 2. MFIs and Institutional Theory of Saving

Financial education is one of the major components of the institutional theory of saving. Once a client formally involves with an MFI, they are presented with some financial education, such as how to use credit and reasons for savings through effective peer monitoring and training. Almost every week (to repay the loan installment or deposit meager savings), the clients of MFIs have a meeting that is chaired/governed by a loan officer or a leader of the respective group and other group members where relevant financial issues are discussed. It is apparent from the literature that people with financial education, e.g., how to save behave differently from those who lack such knowledge (Bernheim & Garrett, 2003; Han & Sherraden, 2009; Lusardi, 2003). The fact that MFIs has provided such platforms to learn financial education from their peer members — that would not have been possible otherwise plays a significant role to shape the mindset of the poor.

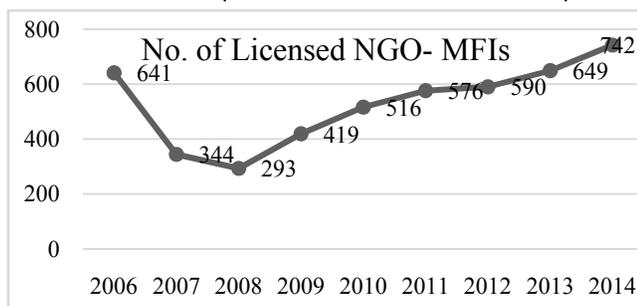
Although poor people have limited financial resources to save, their hope about the incentives for the hardly earn pennies certainly higher than the wealthy savers. It is observed that deposit rates in microfinance remain competitive and comparable to that of the formal banking sector (MRA, 2014). In some cases, MFIs even provide slightly higher deposit rates to attract more savers, who may have otherwise deposited in formal banking sector if the rate was high in the latter. Apart from that, there are additional advantages of savings in MFIs; such as, tax-exemption, rebates and opportunities to take more loans that may motivate poor to save in MFIs rather than depend on formal financial institutions.

Facilitation— means providing assistance with participations and savings (Han & Sherraden, 2009). This is one of the key features in contractual savings program offered by MFIs. In most cases, savings facilities immediately start when a client register him or herself with a MFI for a loan purpose. This is kind of an automatic system and does not require having a separate account for deposit and credit. However, those who only want to deposit without taking any loans are required to have their savings account and it may vary from one MFIs to another. Furthermore, MFIs also provide several types of savings schemes including voluntary and compulsory to meet the financial demand of their clients (Mia & Chandran, 2016). Another component of the saving theory— expectations; which is also institutionalized in MFIs savings schemes. Clients deposit their saving based on an expectation that they can use their savings to invest in productive assets or apply for larger loans that can generate income for them through investment. This is quite similar to the saying of Benjamin Franklin, the founding father of the United States, that ‘a penny saved is a penny earned’(Schreiner et al., 2005). Nonetheless, the amount of loans that can be taken also depends on the amount of

savings deposited to the particular MFIs in most of the cases. The more the amount of savings of a borrower, higher would be the amount he/she can apply for loans.

The cost of saving is certainly important for the poor. However, it becomes easier for the client to access financial services — particularly the savings — for almost at no monetary cost when depositing in MFIs. MFIs have developed various demand-based and customer-friendly savings products that can be easily accessed by the poor. Unlike commercial banks, where the depositors need to go to the branch/ATM or agents to deposit their savings, the uniqueness of MFIs is that the loan officers come and collect it from their clients and this is the common practice among all the MFIs in Bangladesh. Hence, the opportunity cost of deposits in MFIs is much cheaper than the formal banking sector from the vantage point of a saver. The rapid growth of the sector and branch expansion throughout the country also provide close proximity services to the microfinance clients in Bangladesh. Although, the distance is one of the major factors in reaching the poor, particularly in rural areas; MFIs managed to absorb the cost through their innovative delivery methods and products. Until June 2014, a total of 697 MFIs with branches amounting to 16,911 were actively providing financial services to the millions of poor (MRA, 2014). Among 64 districts in Bangladesh; Dhaka and Chittagong, the capital city and commercial capital of Bangladesh respectively accommodate over 120 MFIs (MRA, 2010). The allocation of MFIs and their branches throughout the country makes it easily accessible for the poor to enjoy financial services from the MFIs. Figure 2 depicts the number of NGO-MFIs in Bangladesh from 2006 to 2014.

Despite having various types of savings products, MFIs has some inherent limitations and restrictions that received a good deal of attention recently. For example, if a saver (individual saving) wants to withdraw the deposited amount (flexible or fixed savings) before the maturity date, he/ she may not get the full amount with proposed return. The service fees and departure charge may deter savers from early withdrawal. This is quite similar to the conventional practice.



Source: Authors' compilation from MRA (2014).

<Figure 2> Registered NGO-MFIs in Bangladesh (2006-2014)

es. However, for the group or joint savings scheme, a different rule may apply as the consent of other group members may also require. For the compulsory savings against the loan borrowed, it is learned that the majority of the MFIs do not allow the withdrawal of deposit amount until the final loan installment is made or until a certain period of time after taking the loan (the duration varies from 8 weeks to 24 or more). That is because the deposited amount work as a collateral, which is partly insured against the loan taken and forced savings for the clients (Dowla & Alamgir, 2003). Unlike the conventional banking system, MFIs clients are not eligible to issue checks against their deposited amount, which is one of the main limitations. This is mainly due to the informality and weak institutional capabilities of the MFIs to provide such service. However, it motivates clients to save since restrictions shape the savings behavior of poor by resisting the temptation of spending the deposit.

The last institutional component; security, is one of the main fundamental issues in saving contract. Moreover, regulation in the sector is also a major hurdle in developing savings products and providing these savings services to the poor (Cozarenco, Hudon, & Szafarz, 2016). The issue was severe before the formation of Microcredit Regulatory Authority (MRA) in Bangladesh, which now controls and supervises the microfinance sector. After the establishment of the MRA in 2006, every MFI is now required to be registered with them to operate microfinance programs in the country. Hence, depositing in registered MFIs is secured and the MFIs are legally liable for any illegitimate wrongdoing with their client. To support the hassle free savings and other services, MRA has established a rule that no NGO-MFI can generate deposits more than 80% of their total loans outstanding. This rule has made deposits to MFIs less risky — thanks to the authority, and it is possible to consolidate the assets to repay the savers in case of default or termination of an MFI operational activity. Those collective initiatives taken by both the authority and MFIs have substantially increased the size of the sector and generated US\$1.37 billion of savings that account for over 37% of the total loan outstanding in 2014 (MRA, 2014). However, we should note that those MFIs are not registered with MRA or other respective authorities that allow mobilization of savings are not eligible to take deposits from their clients.

### 3. Conclusion

MFIs have gradually expanded their operation from a sole credit-making to deposit-taking institutions, a transformation that deserved to be praised due to its aptness. This transformation mostly benefited the poorest of the poor,

particularly the women, where they have now a safer place to deposit their meager savings. Based on the institutional theory of saving, it is likely that an MFI has all the seven institutional properties' to be considered as an ideal deposit-taking institution, at least in the Bangladesh microfinance sector. Among these institutional characteristics, information, incentives, facilitation, expectation, access, restrictions and security are briefly discussed. The microfinance sector in Bangladesh should develop and promote their savings activities, such as a savings scheme to target elderly people, investigating the possibility of issuing checks, roaming savings facility and long term flexible savings packages could further ensure the financial needs of the poor, and MFIs will remain a prime choice for the unbanked and marginalized poor to deposit their meager savings.

This study sheds light on the institutional properties of MFIs based on the 'institutional theory of saving'. However, there are some inherent limitations that will require further investigation in the future. For example, empirical analysis of the interplay between institutional properties of MFIs and savings of the poor could enhance the existing literature and standardized the theory in the context of microfinance. In addition to that, in-depth case studies should be carried out to investigate the dynamics of innovations of MFIs that generate a significant amount of savings and the findings could be used as a benchmark to derive important policy prescriptions for the non-performing MFIs (those MFIs could not generate sufficient savings).

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