Policy brief
2015 | December 2011

Pascaline Dupas and
Jonathan Robinson

International Growth Centre

Enabling Microenterprise Development in Sub-Saharan Africa through the Provision of Financial Services

In brief

- Evaluations show that microcredit is not the panacea of poverty alleviation many hoped for. Thus, there is a growing interest in how the savings of the poor can kick-start growth. However, the majority of people lack basic banking services in Sub-Saharan Africa.

- This study compares the impact of access to formal savings and credit on the rural poor in Western Kenya, focusing on a sample of micro-entrepreneurs and subsistence farmers. Almost 80% of those interviewed say they prefer formal saving devices over informal saving mechanisms; yet only 18% offered free savings accounts actively use them.

- One explanation is that fee structure can exclude the poor from accessing formal savings. Charges for withdrawal and monthly charges can erode the savings of small savers and disincentivise people to bank formally. Financial institutions will lose customers if they fail to offer products with fee structures the poor can manage.

- Another factor is that there is insufficient regulation and poor management, which undermines efforts to provide savings services to the poor. Roughly 20% of respondents feared embezzlement of funds, and over a third cited unreliability as a major concern. Past experience regarding limits on withdrawals shape this view.

- **Policy Recommendations:**
  - Investment in experimentation with new financial products designed to serve the poor, especially the poorest of the poor, should increase.
  - Institutional capacity building and oversight should be improved in order to create well-functioning institutions that customers can trust and rely upon.
  - Countries should provide deposit insurance for deposit-taking institutions to prevent customer losses in case of institutional financial distress.

DIRECTED BY
FUNDED BY

Motivation

Microcredit has been growing as a popular means of attempting to empower the poor and enable developing-country entrepreneurship since the 1970's. It is also an increasingly common profit-making, market-expansion strategy for commercial banks, especially in Kenya, the location of this study. But in the midst of this steady proliferation of MFIs and commercial bank micro-lending, rigorous evaluations of microcredit initiatives have not shown them to be the panacea to poverty alleviation or small business development to the extent that many in the industry had claimed (Karlan and Zinman 2010; Banerjee et al 2010; Crépon et al 2011). Given the challenge pro-poor institutions face of staying solvent while lending to the poor, and the tension between expanding market base and turning a profit that commercial banks face, sustainable micro-lending to the poorest of the poor might not be a realistic, long-term option, and this segment of the population could end up either excluded from formal access, or face negative consequences of borrowing low-yield, high-interest microloans. Outside of Kenya, microcredit has very recently become a politically contentious issue in South Asia and Latin America, where politicians, even heads of state, have accused the institutions of over-indebting their clients, sparking non-payment movements in some countries (Bajaj, 2011).

"There is a burgeoning interest in understanding how savings could be a sustainable mechanism by which the poor start and grow their businesses, invest in the future and smooth business and household income shocks"

As such, there is a burgeoning interest in understanding how savings could be a more sustainable mechanism by which the poor start and grow their businesses, invest in the future and smooth business and household income shocks. The majority of people in Sub-Saharan Africa, however, lack basic banking services (Kendall et al., 2010). In step with this, more microfinance institutions in Kenya, once devoted only to credit, now take deposits, and commercial banks, beyond lowering their borrowing minimums, have been expanding account services into lower-income areas, both promoting their own savings devices as well as incorporating new technology (like MPesa mobile phone banking) to reach this population. Members of the donor community have shown themselves to be very responsive to the evidence from the field, sponsoring large savings research initiatives based on early studies (like Dupas and Robinson 2011).

The ultimate objectives of this study are to compare the impact of access to formal savings and formal credit on the rural poor in Western Kenya, focussing on a sample of micro-entrepreneurs and subsistence farmers (potential entrepreneurs). Interim findings, however, reveal a surprisingly low take-up of the savings products offered in the area among the study population: 18%. This brief presents insights into the potential causes for this low take-up and recommends changes in product design and institutional regulation in micro-finance, especially pertaining to savings, in Kenya and beyond.

Impact

The findings of this study should impact decisions concerning the design of financial products and capacity building in financial institutions targeting the poor in developing countries.

Audience

"Almost 80% say they prefer formal savings devices...Yet only 18% of those offered free savings accounts at a commercial or village bank actively used them"

This brief should be shared with professionals in all levels in the micro—finance industry, including commercial and not—for—profit, in Kenya, sub—Saharan Africa and the developing world generally. This includes staff and decision—makers in financial institutions and any government representatives making decisions regarding the micro—finance industry in their country. The brief should also target donors supporting microfinance initiatives and/or research.

Policy Implications

In interviews with a subset of study participants, we find that almost 80% say they prefer formal savings devices (some sort of bank) over informal savings mechanisms. Yet only 18% of those offered free savings accounts at a commercial or village (community-owned) bank actively used them. Why?

Fee structure can exclude the poor from accessing formal savings

Over one-third of the respondents reported being concerned with fees associated with the accounts in the Commercial Bank in our sample. Indeed, the Commercial Bank charged .30USD per withdrawal, regardless ofthe withdrawal size. This can represent a large fraction of the withdrawal amount for small savers. In addition, the bank recently instituted a monthly account fee of .55USD that will be automatically deducted from all users of the type of account held by the participants in this study. Qualitative interviews bore out anecdotal evidence of respondents' previous experiences with commercial banks, where they attempted to withdraw funds only to find that fees had eroded their savings. Financial institutions reaching out to the poor will fail to recruit and lose existing poor customers if they do not have products with fee structures that the poor can manage. In addition, changing (adding) fees after an account is opened without a reliable way to communicate this in a timely fashion to customers that do not use mail or internet, and may have limited or unreliable mobile phone access, could destroy any burgeoning relationship between the poor and the formal banking sector.

Insufficient regulation and poor management can undermine efforts to provide savings services to the poor

"Over one-third of respondents reported being concerned with fees...Indeed, the Commercial Bank charged .30USD per withdrawal, regardless of the withdrawal size"

About 20% of respondents said they feared embezzlement of funds and over a third cited unreliability as a major concern, with regards to the Village Bank in our sample. Their concerns are not unfounded. Just before the study launched, bad lending created a liquidity crisis in the main branch in our sample, leading to a protracted limit on withdrawals. The management reshuffling that ensued led to the temporary closure of another branch in the sample. Although that has since re-opened, spot checks reveal that it remains unstaffed roughly 1/3 of the time it is supposed to be open and operating. This bank is part of a network of community-owned institutions supported by a well-reputed larger bank that supports the microfinance industry in Kenya, and is designed to make financial services accessible to the poor. They cannot succeed in their mission if their services are not trustworthy or reliable - and they are not an outlier. Low institutional capacity in the microfinance sector is considered to be one of the main obstacles to developing quality financial services for the poor (European Commission, 2011).

Implementation

Recommendation 1

Investment in experimentation with new financial products designed to serve the poor, especially the poorest of the poor, should increase, to allow financial institutions to discover mechanisms for effectively banking the poor.

Possible constraints in implementation: MFI, community and commercial banks must remain solvent, if not profitable, according to their institutional mandates, and might have a disincentive to devote resources to risky experimentation on new products to capture the very bottom of the market.

Possible solutions: This is an excellent way for international donors to make an impact and fill a gap in a way that allows financial institutions to assume less risk during the experimental phase. Donors should fund the design and experimentation process for different, innovative savings products designed to help the very poor save formally. A percentage of these customers would hopefully eventually transition away from these products, graduating to more traditional financial products.

"Countries should provide deposit insurance for deposit-taking institutions to prevent customer losses in case of institutional financial distress"

Recommendation 2

Institutional capacity building and oversight should be improved in order to create well-functioning institutions that customers can trust and rely upon.

Possible constraints in implementation: Resource constraints limit the availability of human and technological resources available for improving and monitoring institutions.

Possible solutions: Governments and donors should not only focus on increasing access, but also on improving and maintaining quality services. Funding should be provided at the both the customer service and institutional management and oversight levels, and industry oversight levels, to establish and monitoring quality and business ethos.

Recommendation 3

Countries should provide deposit insurance for deposit—taking institutions to prevent customer losses in case of institutional financial distress.

Possible constraints in implementation: Many African countries do not have deposit insurance. Even in those that do, like Kenya, not all deposit-taking institutions (like the community-owned bank that participated in this study) qualify for it.

Possible solutions: The establishment of deposit insurance in places where it does not exist is part of a greater issue of building a more sophisticated, higher-quality banking system in African countries. In countries that do provide deposit insurance, greater assistance in institutional capacity building and navigating bureaucratic steps to qualify the insurance should be provided.

Dissemination

An attached list of attendees to the Banking the Poor conference in Kenya in August 2010. These representatives from micro—finance institutions, commercial banks, researchers and others have received the full academic paper on which this brief is based.

Further Reading

Collins, et al, 2009. Portfolios of the Poor: How the World's Poor Live on $2 a Day.

CGAP's Microfinance Gateway http//:www.microfinancegateway.org/p/site/m/

Daily Nation (2011). Deposit taking microfinance agents to be put on check, December 27, 2011, ' www.nation.co.ke/business/news/Deposit+taking+microfinance+agents+to+be+put+on+check/-/1006/1296088/-/rtdmdtz/-/

References

Banerjee, Abhijit, Duflo, Esther, Rachel Glennerster, and Cynthia Kinnan (2010). The Miracle of Microfinance? Evidence from a Randomized Evaluation. Mimeo, MIT.

Crépon, Bruno, Florencia Devoto, Esther Duflo and William Pariente (2011). Impact of Microcredit in Rural Areas of Morocco: Evidence from a Randomized Evaluation. Mimeo, MIT.

Dupas, Pascaline and Jonathan Robinson (2011). Savings Constraints and Microenterprise Development: Evidence from a Field Experiment in Kenya. NBER Working Paper #14693.

European Commission (2011). Better Access to Finance for Poor People. http://ec.europa.eu/europeaid/what/economic-support/microfinance/index_en.htm

Karlan, Dean and Jonathan Zinman (2010). Expanding Credit Access: Using Randomized Supply Decisions To Estimate the Impacts. Review of Financial Studies 23(1): 433-46

Kendall, Jake, Nataliya Mylenko and Alejandro Ponce (2010). Measuring FinancialAccess around the World. World Bank Policy Research Working Paper 5253

Bajaj, Vikas, (2011). Microlenders, Honored With Nobel, Are Struggling, New York Times; January 5, 2011. http://www.nytimes.com/2011/01/06/business/globaI/06micro.htmI?scp=1&sq=india%20+%20microfinance&st=cse

About the authors

Pascaline Dupas is an Associate Professor in the Economics Department at Stanford University. Dupas' areas of research are applied microeconomics and development economics. She is currently conducting field experiments in health, education, and microfinance.

Jonathan Robinson is an Associate Professor in the Department of Economics at University of California – Santa Cruz.

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

Find out more about
our work on our website
www.theigc.org

For media or communications
enquiries, please contact
mail@theigc.org

Follow us on Twitter
@the_igc

International Growth Centre,
London School of Economic
and Political Science,
Houghton Street,
London WC2A 2AE

International
Growth Centre

Designed by soapbox.co.uk