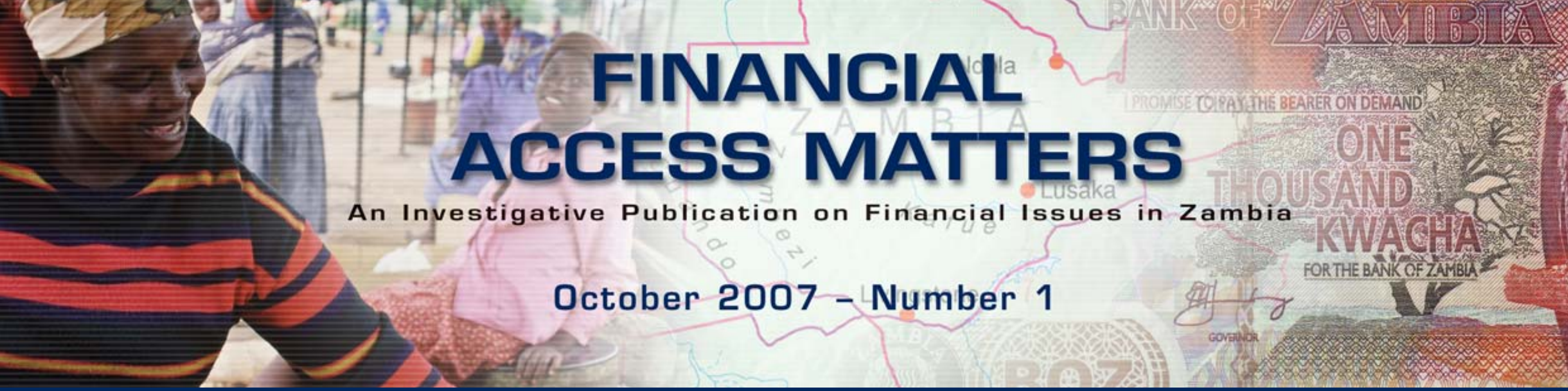


MEASURING THE POTENTIAL FOR SAVINGS PRODUCTS

Introduction

Savings can be defined as cash held back from day-to-day spending by an act of will. Savings transform small cash flows into useful large lump sums. Savings can be grouped into traditional savings **(saving up)**, repayment of credit **(saving down)**, and insurance products and rotating savings clubs **(saving through)**. All three transform small cash flows into lump sums[1].

FinScope™ Zambia 2005[2] data indicates that savings are a critical source of funding in Zambia: 47% of homeowners use savings to pay for their homes and 60% of business owners use savings to finance the start-up of their businesses. Accumulated savings also help households cope with financial shocks, particularly when the use of insurance products is limited, as in Zambia. This focus note uses the FinScope™ survey data to look at savings patterns and behaviour in Zambia, explore savings preferences, identify key access barriers and establish the levels of savings in the country using the access frontier methodology[3] .

Use of savings products

Various ways of saving are used in Zambia. These include formal products offered by banks and insurers, both voluntary and contractual, and informal products such as chilimbas. Sometimes savings strategies avoid using savings products and rely instead on alternatives such as hiding or burying cash, or storing value in assets such as livestock and property.

The use of savings products, formal and informal, that facilitate saving up or saving through is illustrated in Figure 1. The limited use of insurance products (precautionary savings) is noticeable.

Source: FinScope™ Zambia (2005)

Figure 1 – Savings products currently used

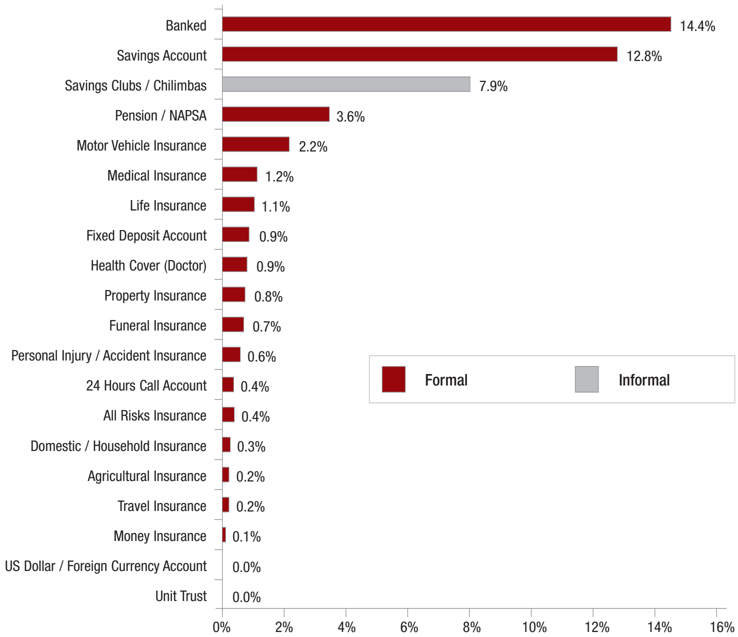
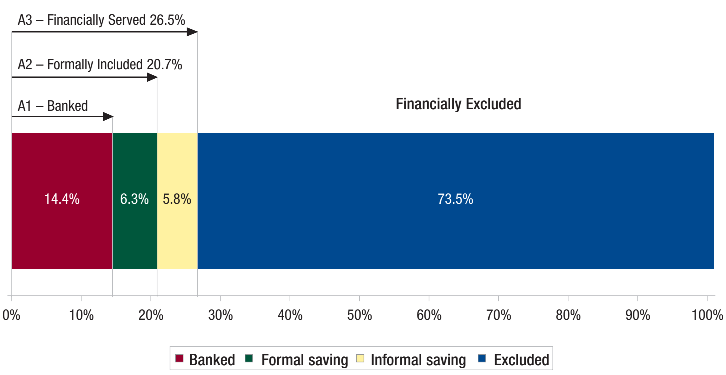


Figure 2 – Savings strand



The savings strand (see Figure 2) uses four categories to summarise the use of savings products. The first category comprises those who are **banked**. Some of those who are unbanked may use other formal savings products such as insurance. Together these two segments are termed **formally included**. A third segment comprises those who make use of informal savings products but not formal products. This combined with the first two segments make up the **financially served**. Those who have no savings products, formal or informal, make up the **financially excluded** segment. Formal savings products include savings and fixed deposit accounts, unit trust accounts, treasury bills and bonds, endowments and pension funds.

1 Source: CGAP Focus Note 15 by Stuart Rutherford, available at http://www.cgap.org/docs/FocusNote_15.html
2 FinScope™ is a demand-side survey exploring how adults interact with financial markets. A FinScope™ survey was conducted in Zambia in 2005. More information can be found at www.finscopeafrica.com.
3 The Access Frontier Methodology was developed by David Porteous and is outlined in a 2005 paper called *The Access Frontier as an Approach and Tool in Making Markets Work for the Poor*, available at http://www.finmark.org.za/documents/2006/July/AccessFrontierTool.pdf.

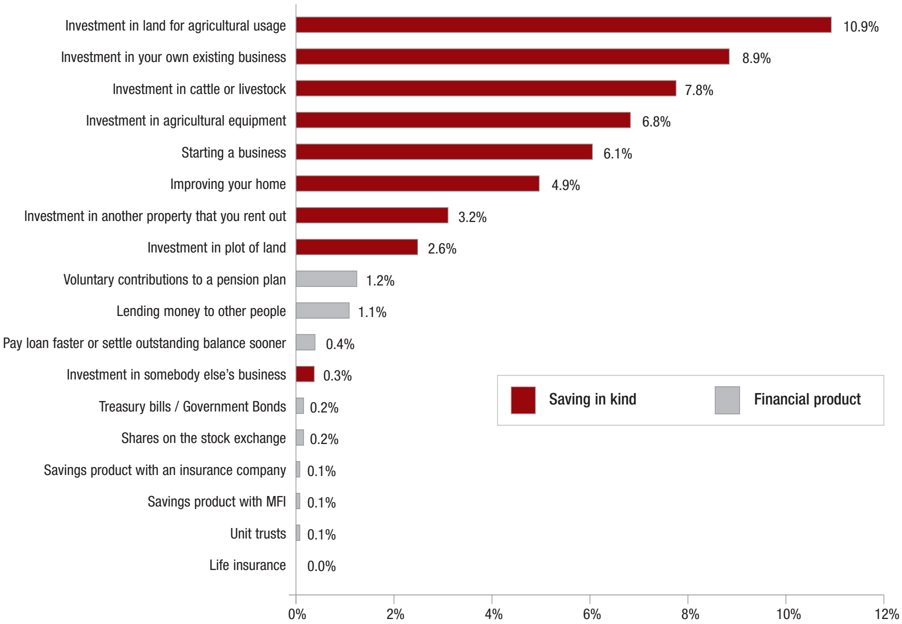
Unsurprisingly, salaried employees are most likely to have savings products – 68% of respondents who receive a salary from a company are banked or have a formal savings product. Education levels are also reflected in the use of savings products. People with high education levels are more likely to have a greater level of financial literacy and higher income levels. According to FinScope™ 70% of those with some tertiary level education are banked or have formal savings products compared to only 4% of those who have no formal education.

In contrast with the limited use of savings products, various responses in FinScope™ indicate a high willingness to save in general. According to the survey, half the adult population agree with the statement, "You try to save regularly".

A significant minority (22% of the population) say they can save regularly. However, of those who say they currently save regularly, 47% have no saving products, formal or informal. These respondents may not be saving through a product but may, through preference or necessity, be using other strategies to accumulate and manage their savings. When presented with a hypothetical scenario of receiving a large sum of money more than 30% say they would hide it, bury it or give it to someone for safekeeping.

Figure 3 - Saving in kind

For these ways of increasing your wealth, which best describes your experience?



Savings in kind is fairly significant (see Figure 3). The use of alternative savings strategies which do not rely on formal savings mechanisms, such as savings groups, burying or hiding cash may, however, be less than optimal. Informal products are unregulated and savers have no recourse if funds are misused. Savings in kind are typically illiquid, often forcing sellers to accept discounted prices, and are difficult to match to desired amounts. Such savings are also at risk of theft or destruction. Lack of formal savings products, most notably a bank account, may also limit access to formal sources of credit.

Source: FinScope™ Zambia (2005)

Access to savings products

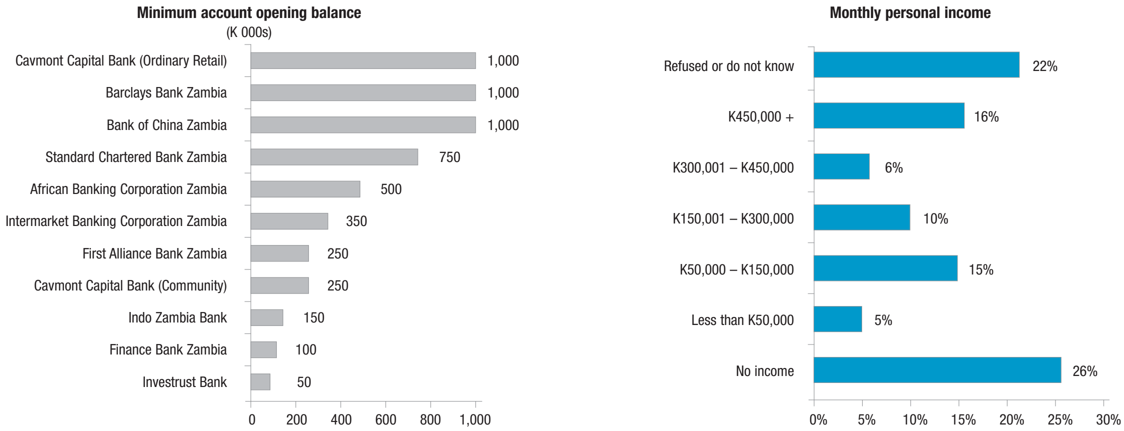
The discrepancy between the use of formal savings and savings activity indicates that access to savings products may be limited. To test this hypothesis, access to bank accounts, endowments and funeral insurance is assessed using the access frontier methodology. This methodology uses survey data together with data on product structure, pricing and distribution to estimate access constraints. The access frontier segments the market into those who currently use the product; those who don't use the product but have access to it; and those who do not have access to the product. This last segment is further broken down into those who do not have access because they appear to be too poor; and those who do not have access because various features of the product effectively exclude them from using it.

Access to bank accounts

A bank account is the most widely used formal product that could be used for discretionary savings purposes, and 14% of Zambians are currently banked. Various factors constrain access to bank accounts. These include affordability relating to threshold costs such as high opening balances. Data from FinScope™ indicates that required opening balances are often much higher than reported monthly incomes (see Figure 4).

Figure 4 - Comparison between account opening balances and monthly personal income

Source: Bank of Zambia, December 2006, FinScope™ Zambia 2005



Affordability is also affected by the high cost of saving through a bank account. Using a product offered by the Zambia National Commercial Bank, for example, the interest income earned by the customer would be 2% a year while the monthly service fees are K10 000[4]. To break even on this monthly service fee a minimum account balance of roughly K5.9 million is needed. Few Zambians are likely to be able to maintain such a high balance. Given present pricing practices, most would have to accept a negative return on their savings.

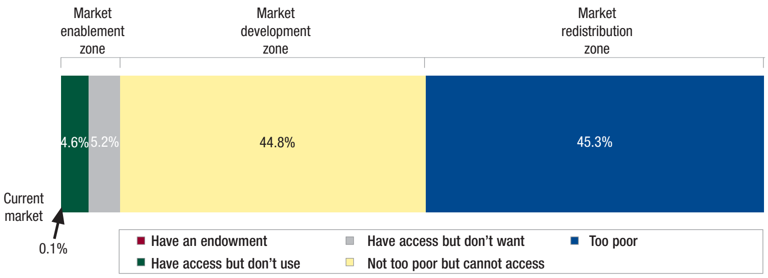
Proximity is another barrier. The costs of the journey to the bank in money and time affect the perceived value of saving through a bank account. According to FinScope™ around 20% of Zambians need to travel for an hour or more to reach a bank. Other factors such as opening hours and the number of branches also affect access. For many, physical access is less than optimal.

In summary, access to bank accounts for savings is severely restricted. If these are to become more accessible, savings products, pricing and distribution need to change significantly.

Access to endowments

Endowment policies are contractual savings products bought on a voluntary basis from insurance companies. Endowment products, particularly those with a guarantee, offer a useful mechanism for targeted savings. According to FinScope™ the current market of endowment product users is negligible at 0.1% of the population (see Figure 5).

Figure 5 - Access frontier for an endowment product



For the purposes of this analysis an endowment offered by the life and pensions division of the Zambia State Insurance Corporation Limited has been used. The term of this product is either five or 10 years with optional life cover. Clients must be 18 years or over to buy the product and must have a national registration card or passport. Premiums are collected monthly, quarterly, bi-annually or annually and are paid via debit order directly from a bank account or through a stop order arrangement via employers. The minimum monthly premium is K20 000.

The **market redistribution zone** comprises those who are too poor for an endowment product. An indicator relating to living standards has been used to identify those in this zone, specifically about the ability of respondents and their households to meet their nutritional needs. In addition, those who personally do not receive an income are regarded as being in the redistribution zone. According to FinScope™ about 45% of Zambian adults (about 2.8-million people aged 16 or more) say their households have always or often gone without enough food to eat over the past 12 months or they personally have no income source.

The **market development zone** comprises those who do not have access to the product for reasons other than poverty, including affordability of premiums, physical access to sales and servicing channels and awareness, both of the benefits of using the product and how to buy it.

For this analysis, a cut-off affordability threshold of 5% of personal income has been used. Given a minimum monthly premium of K20 000, an income threshold has been set at K450 000. According to FinScope™ around 2.3-million adults who are not in the market redistribution zone would be unable to afford the product. Furthermore, product providers require customers to be banked or formally employed to facilitate premium collection either through a debit order or salary deduction. This constraint excludes two-million adults who are not in the market redistribution zone.

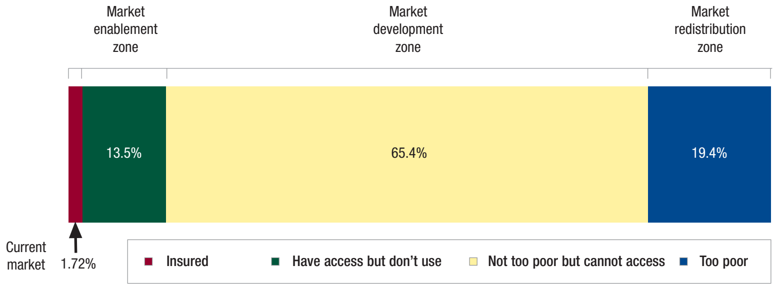
Awareness also restricts effective access. While there is no data with which to assess this constraint directly, according to FinScope™, about one-million adults who are not in the market redistribution zone have not heard of or do not understand the term "insurance". Further constraints relate to age (clients must be 18 years of age or older) and ownership of national registration cards. In total 45% of Zambians cannot access an endowment product because of one or more of these constraints.

The **market enablement zone** comprises those who do not have the product but appear to have access to it. About 10% of the market is in this zone; however, some in this segment may not want to buy the product. According to FinScope™ 47% of adults disagree with the statement, "You would prefer to save money for a long-term goal with an insurance company".

Access to funeral insurance

As funeral insurance is regarded as a household product, this analysis has been restricted to the two-million individuals in the target market who identify themselves as household heads. According to FinScope™ 1.73% of households currently have funeral insurance (see Figure 6).

Figure 6: Access Frontier for funeral insurance



The product provides minimum cover of K500 000 with a minimum monthly premium of K1 000 per life covered. The product is available to those aged 18 to 65 years who have a national registration card or passport. Products are distributed by agents, brokers or via direct channels as well as through banks and microfinance institutions. Premiums are paid monthly, quarterly, bi-annually or annually and can be paid in cash or cheque through branches, intermediaries or the post office or via debit order.

[4] As at June 2007

Data on household living standards has again been used to identify those most likely to be too poor for the product. According to FinScope™ 19% of household heads (about 407 000 households) are too poor for the product (their households always or often have gone without enough food to eat in the past 12 months).

Primary barriers that limit access to funeral insurance include affordability, physical access (to sales and servicing channels) and awareness. Taken together 65% of households appear to experience at least one access constraint.

The potential for savings products

The analysis of FinScope™ Zambia data indicates that there is a relatively high willingness to save, and indeed relatively high levels of reported savings activity in Zambia. However, use of formal savings products is limited. While poverty clearly diminishes the capacity to save, research from various countries, including Zambia, indicates that poor people can and do save. However, through preference or necessity, they often do this in costly and sub-optimal ways. In Zambia it appears that even those who are not extremely poor face significant access constraints that prevent them from using formal savings products.

Affordability: Minimum account balances or premiums are often too high.

Physical access: With a discretionary savings product, such as a bank account, the ability to deposit and withdraw funds easily and at minimal cost is critical. With contractual savings products, including endowments and funeral insurance, lack of access to sales and service channels is likely to inhibit uptake.

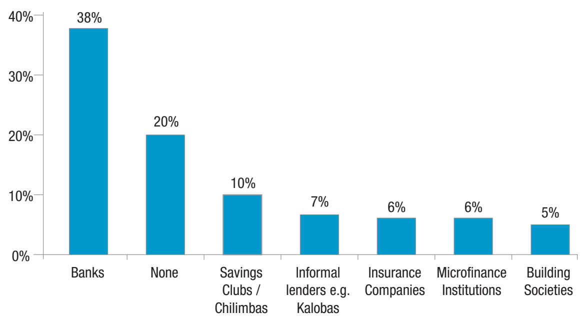
Awareness: Low levels of understanding about basic product terminology indicate a limited awareness of the benefits of having a product, and how to get and maintain a product.

Designing appropriate products

While enhancing access is critical it is not necessarily sufficient to attract depositors. Other considerations and trade-offs may be important in designing appropriate savings products.

Figure 7: Building trust

Percentage of people who associate the statement "You trust them" with ....



Risk and security: Data from FinScope™ indicates a range of preferences relating to the risk-return profile of desired savings products. Most respondents appear to be risk averse and place a premium on the safety of their savings – 54% agree with the statement, "You prefer to save where your money is safe, even if the interest rate or return is lower", while only 16% agree with the statement, "You are prepared to put your money into accounts with higher interest rates, even if your money is not safe". Formal institutions do not automatically have the trust of the market (see Figure 7). While 36% of the population say they do not trust informal associations such as savings clubs, more people associate feelings of trust with chilimbas and informal lenders than with insurance companies or microfinance institutions.

Flexibility of contributions and pre-commitment constraints: Income is often earned sporadically: 36% of Zambians say their households have gone without cash income always or often in the past 12 months, and a further 42% say their households have gone without a cash income often. For these households the ability to reliably pay premiums or contribute regularly to a savings product may be diminished. On the other hand, a product that compels regular contributions can be highly valued by some savers.

Liquidity preferences: While many savers prefer to access savings as needed, others prefer to earmark savings for a specific purpose with fairly rigid limits on when these can be accessed.

In developing savings products, it is critical to develop a clear picture of the preferences of the target market about any savings objective. There is a sufficiently large potential market to warrant further investigation into these objectives and preferences, so as to design products that are attractive, as well as accessible, to potential savers.

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