When is a Savings Account not a Savings Account?

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There are two principal financial products in banks and microfinance institutions:

- demand deposit accounts or "transaction accounts" and
- fixed deposit accounts or "accumulation accounts"

The transaction account is a way of reducing transaction costs, while accumulation accounts or commitment-based fixed deposit accounts are a way of getting an income. People open transaction accounts to facilitate payments and the aim of the financial institutions offering such an account should be to minimize costs as much as possible in order to add transaction value for its clients. The purpose of an accumulation account is to maximize returns, so while transaction accounts aim at smoothing financial flows, an accumulation account is a way of increasing financial stocks. The two have an opposite logic and different costs in terms of activity based costing.

To use the word "savings account" to refer to both is a recipe for confusion but is not unusual in microfinance circles. This is evident from the way people use money. When an average person refers to his savings, he is not referring to his cash-at-hand or what he has in his demand deposit or transaction account but to the money he has set aside for use in case of specific events or for old age, education, emergencies, etc. In other words, people have different mental models for these two accounts and the physical account should reflect this separation.

If we accept the above argument, then it is better for a saver to use a separate account for accumulating and a different account for transacting instead of having a single "flexible" account. There are several benefits to this separation including better transparency of costs and better incentives for accumulation. Some transaction accounts require a minimum balance to be kept and this will receive lower interest than balances in fixed deposit or accumulating accounts. A depositor would therefore be getting a bad deal on his minimum balance which, after all, is a form of long term savings. Some transaction accounts offer free banking with a minimum deposit, which would be attractive for those with frequent transactions but not for those with few transactions. Again there is a transparency issue, since self-employed people (who are the main clients of microfinance institutions) are unlikely to know the number of times he/she would transact.

Many microfinance institutions (MFIs) attribute costs equally amongst all their clients without regard to the fact that some are mostly using the account for transacting and some are trying to accumulate. For example, if an MFI provides a daily collection service, they do so without regard to the fact that some clients may not need daily visits but only weekly or even monthly visits. In this case, those who are accumulating and probably not borrowing are essentially subsidizing those who are the frequent daily transactors and who are probably also the borrowers. This subsidy is essentially reducing the returns for those who are trying to accumulate and could become a disincentive for long term savings.

The transparency issue is even worse in cases when say one third of a client's savings are blocked in order to provide access to loans. Here the borrower is essentially borrowing his or her own money and paying interest on it. For example, a client who is charged 36% on loans and gets 16% on savings is paying a net interest of 20% per year. Here the institution is also blocking the borrower's transactions (blocked savings) because of the loan. The transaction account which is supposed to lower transaction costs, in this case has increased such costs.

With a blocked savings account, a client would do better to look for an alternative account for transactions and this business would then be lost to the institution, as well as creating additional costs for the client. Mark Staehle of SafeSave in Bangladesh has rightly observed that "requiring savings to access a loan seems to have slowed the development of a 'saving culture' amongst both staff and clients." I would argue that this disincentive originates in the concept of "flexibility" mentioned at the start of this note and referring to deposit accounts which are meant to be both transactional and accumulative. What is really needed is three accounts: one for transactions, one for accumulation, and one for a loan. It would be interesting to know the client retention rate of microfinance institutions with these transparency issues and if they have caused some people to stop using their services.

Another aspect is that transaction accounts are often the entry level for most clients and should perhaps be subsidized or at least priced at cost recovery. South African banks admit that low cost transaction accounts are expensive for the bank but necessary to help the clients migrate up the ladder of products. They call these extra costs "school fees" because for the bank it is like going to school to learn about low income clients and for the client it is about learning to bank.