Village Savings and Loans Associations – sustainable and cost-effective rural finance

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MFIs and banks find it difficult to cover the costs of providing rural financial services – especially in Africa. In its large-scale Village Savings and Loans Associations (VS&LA) programmes in Africa, CARE is tackling these difficulties by encouraging the formation of village loan funds entirely composed of members' savings, keeping the time-bound savings and lending methodology very simple and limiting external involvement to a one-year training and follow-up period. This article describes how the methodology works in principle and practice and describes evaluation results from the CARE VS&L programme in Zimbabwe, where very high rates of inflation pose a challenge to any microfinance programmes. Finally the need for management information systems and better record keeping are identified as issues that need further development.

IN THE LAST 20 YEARS, microfinance has firmly established itself, not only in the lexicon of development practice, but also in the public mind. The Grameen Bank, with its nearly three million clients, is a household name. Mainstream financial institutions are beginning to offer microfinance products, and microfinance institutions (MFIs) are establishing themselves as formal-sector financial intermediaries.

Especially in Africa, however, it is becoming clear that while many banks and MFIs provide valuable services to the poor, they are most successful in urban areas, where borrowing requirements are high and the costs of reaching clients low. Most of the people who live in rural areas and in urban slums (and particularly the very poor) receive no services at all. Thus, there is still a very large gap between the needs of the poor for financial services and the ability of banks and MFIs to provide these services. Moreover, the gap cannot be filled by these types of institutions because in most cases they will never be able to cover their costs.

Most rural dwellers receive no financial services at all

In addition to the gap in service delivery, there is also a gap between the products that MFIs can offer and those that are needed by the poor. MFIs tend to emphasize credit. Most are unable to offer savings services, because only a few are licensed to take deposits and only a minority are beginning to offer insurance. The conventional view is that credit is the most important service that an MFI can offer, because it provides the means by which the poor can invest their way out of poverty. But this view is increasingly being challenged by practitioners, who observe that many poor people prefer to build and protect their assets through savings and insurance rather than increase their risk exposure by taking out loans.

MFIs are aware of this gap and are struggling to create efficiencies that enable them to extend their outreach. Opportunity International, for

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example, is experimenting in Mozambique and Malawi with mobile banking; low-cost kiosks in rural market centres and the use of smart-card technology and fingerprint recognition. But it is clear that cost-reduction and new technology have their limits and full market penetration will never be achieved at reasonable rates of interest (which currently vary between 50 and 100 per cent per annum – a very real tax on rural capital formation). There are, then, limits to MFI outreach or, to put it another way, to solutions that depend on conventional institutional structures.

Consequently, there need to be alternative models based on a revised conception of institutional roles that are able to provide the rural poor (and the urban very poor) with services that can be delivered cost-effectively. Such models need to provide a secure place to save; insurance services and the opportunity to borrow in modest amounts. They should provide convenient access to these services; be easy to understand and transparent in operation. They must also be inexpensive to set up and capable of community-based management.

In the last 14 years CARE International has developed and extensively tested such a model. Originally applied in Maradi, Niger, in 1991, the VS&L (Village Savings and Loan) methodology has now been replicated in 21 countries worldwide, 17 of them in Africa. The number of participants currently stands at a total of 718 000: 428 000 in Africa. This is comprised as follows: Niger 182 000, Zimbabwe 56 000, Rwanda 43 000, Tanzania 35 000, Uganda 26 000, Mali 50 000, Mozambique 15 000, Kenya 6000, Zambia 6000, Angola 4000, Eritrea 4000, Ethiopia 3250, South Africa 2000. There are, in addition, 290 000 participants in India and an unknown number in Peru, Ecuador and Vietnam

> The project cost per client is approximately 10 per cent of the cost needed to develop an MFI client

The cost per client (all project costs, including overheads) averages $25–40 (approximately $15 in India): this is about 10 per cent of the cost needed to develop an MFI client. CARE's experience in starting MFIs in Africa is that it costs between $200–300 per client (all project costs and overheads included) by the time the MFI reaches full financial sustainability. Because VS&L costs so much less, there is increasing interest in the model among other development agencies. For example, Oxfam USA, Plan International and CRS in Africa are adopting their own versions of VS&L (and collaborate with each other) and PACT has independently developed a similar methodology, focused on women and emphasizing literacy.

Experience with VS&L has matured over the years. Starting out with a very basic approach, designed only for impoverished and uneducated rural women, it now has versions of the model for both literate and non-literate people. These have been thoroughly tested both in rural areas and urban slums. Using this experience CARE has refined the tools that are needed to implement a successful programme.

> Successful implementation of the VS&L does not need highly trained experts

The VS&L model has the potential to reach very large numbers of the poor, because it can be implemented in a wide variety of institutional settings, from multi-sector rural development projects to stand-alone financial services projects. Successful implementation does not need highly trained experts, large budgets and long time frames to reach sustainability. Furthermore, financial services groups formed through this model provide the basic building blocks on which future integration into the formal financial sector through networks and federations may be possible.

ROSCAs and ASCAs

The most common type of traditional savings and loan institution in

Africa is the Rotating Savings and Credit Association (ROSCA). Known variously as *tontines*, *iqqubs*, merry-go-rounds, *osusus* etc., ROSCAs are simple, transparent and extremely efficient mechanisms for financial intermediation. They require a group of self-selected members to make regular equal contributions into a fund. On the basis of a lottery, a schedule or need, each person in turn receives the total contribution at each meeting. They need no written records nor complex institutional structure, but what they cannot provide is credit matched to investment opportunity; business or emergency loans when needed, or a return on savings invested. They offer the advantages of generating a regular, useful lump-sum and the time value of money to members who receive their share somewhat prior to the half-way point in the cycle.

CARE creates Accumulating Savings and Credit Associations (ASCAs), which it calls Village Savings and Loan Associations (VS&LAs). A VS&L Association is entirely self-managing and does not receive external capitalization. It is a self-selected group of people (usually unregistered) who pool their money into a fund from which members can borrow. The money is paid back with interest, causing the fund to grow. The regular savings contributions to the association are deposited with an end date in mind for distribution of all or part of the total funds (including interest earnings) to the individual members, usually on the basis of a formula that links payout to the amount saved. This lump sum distribution provides a large amount of money that each member can then apply to his or her own needs.

ASCAs usually offer a high rate of return on savings

ASCAs, or VS&LAs, are usually more attractive to participants than ROSCAs, because they offer the opportunity to save in varying amounts, a high rate of return on savings (normally much higher than the rate of inflation); provide loans in useful amounts usually in excess of the borrower's savings, at times that are convenient to the borrower and tailored to the need or opportunity. While not as widespread as ROSCAs, they have emerged in many parts of Africa and are most firmly established in coastal West Africa from Côte d'Ivoire to Sierra Leone. The reason that ASCAs are not as common as ROSCAs seems to be that they call for a higher level of organizational structure, disciplined procedure and a basic form of record-keeping (written or memory-based). It is because these things do not normally emerge spontaneously that the role of the NGO is critical in assisting adoption.

ASCAs, or VS&LAs, require a higher level of organizational structure than ROSCAs

How the methodology works: principles

The basic principle of the VS&L system is that members of a self-selected group save money, which then forms a source of loan capital from which they can borrow. The purpose of a VS&LA is, principally, to provide savings and simple insurance facilities in a community that does not have access to formal sector financial services, but when the amount of money saved by the membership is sufficient, any of them can borrow from this source and must repay the loan with interest.

VS&LAs are autonomous and self-managing. This is their most important characteristic and is fundamental to their mode of operation and objectives. This cannot be compromised, because a VS&L group's goal is institutional and financial independence. All transactions are carried out at meetings in front of the association, to ensure transparency and accountability. This also ensures that all the members are able to witness who has saved and who has not, who has borrowed and who has not and what this means in terms of net worth, at least once a month (more often

for groups that meet more frequently). To ensure that transactions do not take place outside group meetings, a lockable cash box fitted with three padlocks is employed, to prevent unauthorised cash movement and the risk that records might be tampered with.

The cycle of savings and lending is usually time bound. Members agree to save and to borrow as they wish from the accumulated savings of the group for a limited period of time. At the end of this period the accumulated savings, interest earnings and earnings from other economic activities undertaken by the group, are shared out amongst the membership in proportion to the amount that each member has saved throughout the cycle. VS&LAs that adopt this approach are known as time-bound.

How the methodology works: practice

VS&LAs are made up of as few as five and as many as 30 members. The members are self-selected, usually from amongst the adult population. Membership is open both to women and to men, but at least two of the five committee members elected should be female in the case of mixed groups. If groups are larger than 25 members, they are encouraged to divide into smaller sub-groups because the transactions in larger groups tend to make meetings longer than is convenient.

VS&LAs meet on a regular basis, at intervals that they select, but never less frequently than once a month. VS&LAs are comprised of a general assembly and a management committee. The general assembly is the supreme body from which the management committee is elected and from which it derives its authority. Each member has only one vote. The management committee of a VS&LA consists of five people: a chairperson, secretary, treasurer and two money counters. Committee members are subject to annual re-election at the start of a new cycle. They may be removed at extraordinary meetings.

> The regulations provide authority to the committee members for dispute resolution

VS&LAs agree on a set of rules, or a constitution, to guide their activities. The regulations are written in to the association's constitutions (sometimes called by-laws) and are intended to provide authority to the committee members: a framework for regulation and dispute resolution. The constitution also specifies the terms and conditions of savings and lending and how a social fund can operate.

VS&LAs agree on an operating cycle. Before starting to save or to lend, associations agree on how long they will operate before terminating savings and lending activities and sharing out all or part of the accumulated funds. The length of this cycle should be between six months and a year.

> Group members decide on the size of the share – a fixed minimum sum contributed every time the group meets

VS&LA members meet regularly and contribute to a group fund in the form of a fixed minimum sum, or share. The amount is set by the association, and is such as to allow the poorest members reliably and regularly to pay the share which is recorded as a stamp in the member's pass-book. In fact, nearly all members find it hard to meet the minimum share purchase requirement throughout the entire cycle and considerable flexibility in contribution levels, even below the minimum, is common.

Anyone needing a loan puts forward his or her request publicly to the association. Approval of the loan rests with the general assembly and may be immediately disbursed. Loans are provided for purposes that are agreed to by the association, as noted in its constitution/by-laws. The associations set loan terms. During the first cycle loan terms do not normally exceed three months and in fact may be shorter. The size of a loan available to a member may be linked to the total value of his or her shares – no more than a multiple of this value. This prevents the risk that a mem-

ber may borrow far more than they have saved, and then abscond or be overwhelmed by too much credit. At the same time, it is important that the maximum amount that a member can borrow is in excess of his or her savings, so as to maximize the percentage of funds in use.

Interest is charged on loans and falls due every four weeks. It must be paid at that time, regardless of the length of loan term. The amount of interest charged varies from association to association, fixed as they decide. Loan principal repayments are made when due, or earlier as the borrower wishes. The period of loan repayment may vary as the association may decide, but the full amount of the principal sum lent to the member must be reimbursed at this time, or earlier. If the borrower makes late payment beyond the end of the agreed loan period he or she may be fined and must pay any accrued interest, while the principal sum is rolled over to the next reimbursement meeting.

As the end of the operating cycle approaches, no new loans are issued and old loans are repaid. When all of the association's cash is on hand, the money is shared out amongst the members on the basis of a formula linked to the number of each person's shares, as a proportion of the whole. Thus, if a group has $500 in total liquid assets at the end of the cycle and there are 250 shares bought in total throughout the cycle, the value of each share is $2, regardless of the amount that was paid for the share at the time of purchase. Each person then receives $2 for every share that he or she owns. This formula does not take account of the time value of money, but the share purchase system, which restricts the number of shares that a person can buy at each meeting, limits the extent of opportunistic share purchase late in the cycle.

The share out, or action audit, leaves a clean slate for the next cycle

This share-out (or action-audit) is what distinguishes VS&LAs from SHGs. The action audit (a term coined by FSDU's Paul Rippey) neatly describes an event that mandates resolution of all outstanding issues, including delinquency and variable levels of savings/share contribution, leaving a clean slate for the next cycle. It also limits the amount of money that would otherwise accumulate, requiring more and more sophisticated management. SHGs in India, by contrast, mostly do not make a periodic distribution of performing assets and, as a result, many need to depend on external administrative support.

At this time the group may disband and those who do not wish to continue as members may leave and new members may be invited to join. Once a new cycle begins, members can agree to change the minimum value of a share.

A VS&LA may decide to create a social fund. If it does so, it must agree on a regular, fixed contribution, with everyone contributing the same amount. The social fund can incorporate a number of purposes: emergency assistance, educational costs for orphans, funeral expenses etc.

Impact: the case of Zimbabwe

With inflation at over 400 per cent, Zimbabwe is an exceptionally challenging environment for microfinance

CARE Zimbabwe started to implement a VS&L programme in 1999 called Kupfuma Ishungu (KI). It has grown from an experimental programme to test the Village Savings and Loan Methodology into a rapidly growing network, involving the participation of over 55 000 clients, in more than 7500 associations. The example of Zimbabwe is of particular interest because, with inflation at over 400 per cent, it is an exceptionally challenging environment for microfinance. Of particular interest is that its offshoot, SIMBA, has proven that VS&L is an effective instrument in

Box 1. Results from Kupfuma Ishungu (KI), Zimbabwe

- Household productive asset levels (e.g. small livestock and hoes) increased significantly. Household non-productive asset levels (e.g. utensils) increased very substantially. These purchases were mostly in areas that represent semi-liquid stores of wealth usually controlled by women.
- There was been a smaller but substantial improvement in housing quality.
- All categories of the major food groups were consumed in greater amounts by between 45 and 85% of respondents. Reduced food consumption was noted across all food groups by between 0.7 and 22% of respondents.
- 2/3 of respondents improved access to health services; 11% noted a reduction in access.
- Although only applying to a relatively small number there has been a sharp reduction in the number of children unable to attend school through lack of fees. The investment in school fees is regarded as the single most important service provided to KI members through the savings scheme and is also made feasible through the use of credit.
- Loan funds tended to be used both for consumption and productive activities, with a bias towards production. Shared out funds tended to be used to meet basic needs.
- The number of income generating activities per household increased by 45%. 46% of IGAs were more stable than before, while only 6% were less stable. Household labour allocated to IGAs increased by 48%
- 81% of respondents felt that their status in the community had improved, directly as a result of their association with KI. Member participation in other social groups increased by 83% and accession to leadership or committee membership in these groups increased by 77%.
- At the family level there was increased co-operation felt between husband and wife and increased control over IGA income by women, but there has been no noticeable change in sexual norms or the ability of wives to negotiate safer practice.
- There was a 30%+ reduction in the use of formal sector and traditional savings instruments, in favour of KI group membership. This is a very significant finding, especially in the light of considerable pressure to link such groups to MFIs and banks.

addressing the financial needs of HIV/AIDS-affected communities, by implementation through aids service organizations (ASOs) and other non-specialist local institutions.

In 2004 an evaluation was conducted (Allen, 2004; see Box 1). KI was the only financial system in the country paying a positive real return of about 15 per cent on savings in the entire country. This was at a time when inflation was more than 250 per cent. At the time of writing, with inflation now at more than 400 per cebt KI is unable to keep pace, and in the last two months returns have become slightly negative. But, at a time when some commercial banks are paying as little as 5 per cent per annum, most KI groups are paying an average of 250 per cent.

The evaluation had its limitations. Although 150 members were interviewed in focus groups and 252 household-level surveys were conducted, there was no pre-existing control group, and recall and comparison methods had to be used. Most VS&L projects are now required to use controls and establish rolling baselines, but at the time of the evaluation this was not standard practice.

Sustainability

VS&LAs are extremely popular wherever CARE has implemented the methodology and programmes are characterized by very rapid growth, both in rural and urban areas. One of the most unusual aspects of VS&L is that the implementing agency completes its training and supervision role within a year: the goal is group autonomy and independence. Follow-up studies have shown that 95 per cent of groups continue to operate two years after achieving independence. Delivery of the methodology started out through direct service delivery by paid staff, but, increasingly, this work is being done in mature programmes by village agents who receive fees for training and records maintenance from the groups themselves. This appears to be the most promising new development that many INGOs are pursuing, mostly to good effect. Perhaps most encouraging, there is a steady growth in spontaneous replication without any external input.

There is a steady growth in spontaneous replication without any external input

Emerging issues

Despite the positive beginning for VS&L there are some emerging issues that need to be addressed.

MIS. Most VS&L programmes are locally implemented and give very little attention to data gathering and analysis. Management information systems that work for VS&L are in their infancy and data quality is often poor, and rarely analysed to produce sound management decision-making. Thus, there is no mechanism as yet available that performs the dual purpose of improving management capacity or permitting meaningful comparison between one programme and another. As a result, there are widely differing results (and expectations) in terms of costs, efficiencies and impact. There is, then, an urgent need to develop a set of ratios and standards of financial measurement that enable programmes to assess their own effectiveness vis-à-vis peers and to enable the industry as a whole to assess the cost-effectiveness of VS&L.

Record-keeping. Associations are inherently sustainable from day one because their costs are negligible, but there is a continuing challenge in terms of record-keeping. Fully two-thirds of the 10 000 groups in Niger keep no written records, but stick to a very basic system of exactly similar savings and exactly similar share out, with loans available only for one month. Record keeping that satisfies accounting norms has proven to be too complex and there is an evolution towards simplified systems based on share passbooks and longer-term loans rolled over from month to month to try and offer minimum internal accountability. Keeping it simple is really quite hard. It is quite normal for association records to be in serious disarray and, while the transparency of the methodology protects somewhat against loss and fraud, there is a loss of effectiveness, especially in terms of product range and yield.

It is quite normal for association records to be in serious disarray

Regulation. VS&LAs lie below the regulatory radar screen in every country where CARE has implemented the methodology. Because they are member-based groups who agree to put their savings at risk under conditions of self-management, they represent no threat to non-member assets, nor to the safety of the national financial system. This situation is unlikely to change, except where unusually prescriptive social and regulatory regimes choose to intervene. For the long term there is likely to be an issue of regulatory involvement if and when there is substantial movement towards apex structures, which intermediate savings between

associations and seek legal personality.

Growth strategy. In the last 15 years CARE has focused mainly on direct implementation of VS&L. Increasingly it is working through local partners to initiate service delivery and is seeking to move away from a target-group focus towards a market-based approach. What this will mean is taking a national rather than a regional or local approach in which its potential role may be grant-making and technical support (including M&E) to effective local players. The challenge will be to develop the tools and systems that this larger-scale form of indirect implementation will demand, especially in terms of inter-regional learning and technology transfer.

Conclusions

VS&L has shown that it is an effective complement to traditional microfinance in areas where MFIs are unlikely ever to achieve sustainability, unless heavily subsidized. It is also a very effective tool for non-specialist NGOs (international and local) whose skills base does not, for the most part, permit engagement in the increasingly complex and technically challenging world of microfinance. It costs very little; has a high rate of success; is enthusiastically supported by participants and, most important of all, provides access, simplicity, safety and speed of service delivery. Its limitations lie mainly in the levels of capitalization that groups (whose members save as little as $0.10 a week) can achieve, but this has the collateral benefit of limiting the risk of over-borrowing.

The future of VS&L is unclear. While it is achieving increasing visibility and acceptance, there is a pressure to link VS&L associations with MFIs and banks, but no-one knows as yet how practical this is and what the challenges may be. Usually this pressure comes from outsiders who are left uneasy at the prospect of an unregulated, amoeba-like growth of financial intermediaries that lie below the industry's radar screen. There is felt to be some sort of inherent good in linkage into national financial markets for nominal reasons of efficiency, growth and synergy. It is not at all clear that these feelings are shared by participants themselves, who tend, for the most part, to enjoy their independence. One thing is certain: even in its present restricted form VS&L offers an excellent prospect of financial service provision for very large numbers of the rural and urban poor, and it has the potential to achieve it quickly and cheaply.

Group members usually enjoy their independence

REFERENCE

Allen, Hugh and Pauline Hobane (2004) 'Impact Evaluation of Kupfuma Ishungu, February 2004', CARE Harare and Arusha.