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Working Paper

Using community-driven development in FCS to increase access to appropriate financial services

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Key messages

- The limited extent of formal financial services in fragile and conflict situations has led community-driven development programmes to promote informal group-based financial services.
- Group-based approaches are either savings- or credit-led.
- Savings-led groups help poor members manage risks but initially loans can be insufficient to rebuild livelihoods.
- Members of credit-led groups can access larger loans but this can be to the exclusion of the poorest.
- Group-based financial services are seen as the first rung on the ladder of financial inclusion and not an end in themselves.

This note is an output of the project 'Rebuilding and Restoring Livelihoods through Community-Driven Development (CDD) Approaches in Fragile and Conflict Situations (FCS) in South Asia'. It draws on a literature review and research in four countries and for five case study CDD programmes; the Afghanistan Rural Enterprise Development Programme (AREDP); the Pakistan Poverty Alleviation Programme (PPAF); Pakistan's Federally Administered Tribal Areas Rural Livelihoods and Community Infrastructure Project (FATA–RLCIP); the Nepal Poverty Alleviation Programme (PAF); and the Sri Lanka Reawakening Project (RaP).

1 Introduction

The majority of the CDD programmes studied identify during design limited access to finance as a key barrier to rebuilding and restoring livelihoods for poor households in the area. Poor people need financial tools to:

- Generate useful lump sums of cash for productive assets, preventative health care, school fees or major life events such as weddings;
- Weather bad times, including covering the costs of health care, or cover loss of income owing to sickness or crop failure; or
- Fund day-to-day expenses: storing irregular income such as from farming or trading for basic daily needs.[1]

These three needs can be met through a variety of financial tools, including savings, credit and insurance.

Two key challenges in increasing access to appropriate financial services are (i) the scarcity of formal financial services in many FCS contexts; and (ii) the fact that, when present, formal financial service providers often offer products that are either inappropriate for, or inaccessible by, poor and vulnerable households. Inappropriateness means these products do not adhere to the principles of pro-poor financial services (Box 1). Inaccessibility refers not just to physical distance but also to the restrictions that certain regulatory requirements, including those for collateral in the case of taking a loan and Know Your Customer (KYC) regulations, place on poor and vulnerable people, particularly women.

2 Promoting the development of group-based financial services

Absence of formal financial services within the programme areas has led all programmes, with the exception of FATA–RLCIP, to promote the development of informal group-based financial services. The programmes adopt different models:

Savings-led groups: AREDP develops uses Savings Groups (SGs) with the objective of improving access and linkages to financial resources and services for men and women. These groups do not receive an external injection of funds, meaning the amount members can borrow is limited to that they have been able to save collectively.

Credit-led groups: These groups all receive external sources of funds, with group members then having to complete 'investment plans' in order to access credit. RaP, for instance, develops small groups where the primary objective is 'providing credit access to members of poor households on a sustainable basis'.

Some programmes plan that the savings-led groups will be an important precursor that will graduate into being credit-led groups. Principles and requirements common to both these types of group include that:

- They are to be inclusive of women, the poor and vulnerable and other minority groups.
- Group members are to decide the terms and conditions for group membership, for example for making savings contributions and taking loans.

Box 1: Principles of pro-poor financial services*

Reliability in terms of the delivery of products and services at the promised time and in the promised amount

Convenience: the ability to repay loans and make and withdraw deposits quickly, frequently, privately and close to home

Flexibility: how easily transactions can be reconciled with household cash flow. This means people should be able to transact no matter how small the amount at any time

Structure: characteristics or events that promote self-discipline. This may include planned savings or loan repayment schedules or scheduled visits by financial service representatives. Structure is not important for day-to-day money management but rather for longer-term savings objectives.

* *Ibid.*

1. Collins, D., Morduch, J., Rutherford, S. and Ruthven, O. (2009) Portfolios of the Poor: How the World's Poor Live on $2 a Day. Princeton, NJ: Princeton University Press.

- Groups elect an administrative committee, for example a chair and cashier who maintain financial records of transactions.
- The groups are to be financially self-sustaining, which for all projects is equated with having a loan repayment rate of 95%.

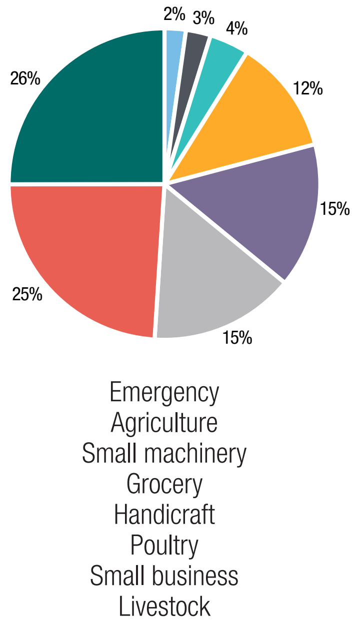
2.1 Savings-led groups

Savings accounts can expand household livelihood strategies. Having safe savings enables poor people to invest in new tools and businesses and can help them better respond to shocks (ill health, death, natural disasters, insecurity). In-depth research into people's financial behaviour reveals that, even the poorest actively manage their money, including saving money under the bed or putting it into assets such as livestock, and that there is substantial latent demand for having a safe place to save.[2]However, the microfinance industry has remained largely focused on credit, even though it is too costly to provide formal savings accounts for individual poor consumers.

Meanwhile, informal savings groups, or 'voluntary associations whose members meet regularly to save and borrow from group funds', often exist already. But there are limitations, including that (i) even though money is locked away in a lockbox, with keys held by a number of members, risk of theft is high and the sums involved can be considerable. Treasurers face enormous responsibilities, and members are often encouraged to borrow to reduce the amount in the lockbox; (ii) members cannot save enough for bulky purchases in one cycle, leading them to have to delay purchases until several cycles are complete; (iii) loans are not available at the beginning or towards the end of a cycle; and (iv) some shocks (e.g. environmental, war) affect all members of a group and may reduce the collective ability to save and repay.[3]

Following restructuring, SGs are the building-block of AREDP. The 5,846 AREDP SGs, of which 53% are female SGs, have saved over $3.5 million and deployed around $3.4 million in internal lending, yielding $1.124 million in profits/interest with a savings turnover rate of 1.6 (up until October 2014). This is the money saved by the people themselves, as AREDP has not given a grant injection to SGs. SGs have proven much more effective than originally anticipated during programme design, when it was believed they may not succeed because of the perceived absence of a collective savings culture in rural Afghanistan. SGs are also seen as particularly appropriate in the context of rural Afghanistan as they bypass the prevalent 'hand-out culture' and encourage ownership of, and responsibility for, development interventions.

Figure 1: Main reason for taking a loan in AREDP (%)



In terms of rebuilding and restoring livelihoods, monitoring data from AREDP reveals that group members are taking loans for a variety of reasons, including to invest in productive activities, maintain consumption and manage shocks (Figure 1). Over 90% of the loans given through the SGs were for productive purposes. [4]

Despite the predominance in AREDP SGs of taking loans for investment, there are two limitations on how effectively this loan can be used to rebuild and restore livelihoods:

1. Loan size – in common with findings from SGs elsewhere, the fact that the loan size is restricted to the level of group savings means loans are often deemed insufficient to truly rebuild livelihoods.
2. Training accompanying the loan – while respondents in this research were happy overall with the training the programme provided, it was generally considered too short and should be offered on a more regular basis. While this does not inherently have to be the case when using SGs to rebuild livelihoods, in the instance of AREDP it does seem to be administratively difficult to offer a wide range of trainings to accompany loans when people take out loans at different times and programme staff do not always know in advance the reasons for taking out a loan.

2. Ibid.

3. BFA (Bankable Frontier Associates) (2014) 'Outcompeting the Lockbox – Linking Savings Groups to the Formal Financial Sector'. Focus Note 1. Boston, MA: BFA.

4. 2012-2013 Afghanistan Trust Fund Annual Report, 2013: 46.

2.2 Credit-led groups

Credit-led groups were the main informal groups the case study programmes formed, adopting different models:

- RaP formed Small Groups with the objectives of ensuring sustainable access to financial services; providing credit access to members of poorer households; developing stronger livelihood support systems; and generating well-maintained and trustworthy credit discipline. There were three approaches to promoting financial inclusion through these groups: (i) through encouraging groups, if feasible, to open a bank account; (ii) promoting group-based savings and credit within the group; and (iii) enabling group members to access external sources of credit provided by the programme.
- PPAF: During implementation, the programme introduced the Community Livelihoods Fund (CLF), a grant given to groups with the objective of rebuilding livelihoods. The CLF aimed to address liquidity constraints facing households. It was introduced after experience during implementation showed that, in the short term, poor households were not going to be able to access credit from microfinance institutions and other formal financial service providers, given the limited reach of such providers in rural Pakistan and the barriers to poor people accessing such institutions – for example the cost of accounts.

Box 2 gives more details of the modalities these groups use. A key characteristic of the credit-led groups is that, following a period of internal savings and loans, they receive an external grant injection from the programme, so enabling group members to take larger loans than they would have been able had they been limited to the group savings pot. Under PPAF, these groups receive a one-off grant, the size of which is related to the amount of money they have saved. Under RaP, there are multiple transfers from the programme to the Small Groups and then on to individuals in those groups.

2.3 Lessons from promoting group-based financial services

Within both types of group there is a certain degree of sequencing of access to different forms of finance. Loans from the revolving fund start small, and are often taken for basic consumption. After a few lending cycles, loans increase in size, and are taken to support working capital for livelihood activities (including dairy and then being used to invest in intensified and/or diversified production).[5] Later on, linkages with other financial institutions are established.

Lessons common to both savings- and credit-led groups include:

- The importance of separate male and female groups in contexts where social norms prohibit mixed groups;
- The need for flexibility in group membership, particularly a minimum number of group members in situations of low population density and mistrust (which is common given the legacy of conflict). Flexibility may also be needed in terms of the characteristic of the group the grant is given to (PPAF originally intended to give grants only to CIGs but over time expanded this to cover suitable COs as well);
- The need for flexibility in the timing of savings contributions and for individuals/their representatives to be present at group meetings in contexts where there is substantial out-migration for work;
- The need to limit group membership to one member of each household owing to the similar nature of financial flows across different household members;
- The importance of having support networks in place and using a local facilitator, somebody from the same village, to provide support to the group. This includes not just training the administrative committee on accounting and bookkeeping but also providing regular 'mentoring' over time to ensure the transparent and correct management of the group's funds and to maintain group cohesion. A key question post-programme relates to if and how this local facilitator will be remunerated and whether group members will be prepared to pay for them through their contributions.

Challenges when using a CDD approach to promote informal group-based financial services include:

- The tension between enabling group members to set the terms and conditions of membership, including requirements for savings contributions and taking a loan, and the objective of the programme to reach and support the poorest.
  Using credit-led groups also poses particular challenges;

- An overemphasis on credit can lead to the exclusion of poor households, or they receive smaller or less frequent loans, which are insufficient to rebuild and restore livelihoods. The extent to which this takes place is also influenced by programme design and implementation arrangements. For instance, under RaP, the Community Resource Person was rewarded on the basis of the level of loan repayments, leading to a tendency for more able households to be those that gained access to a second loan. This was also encouraged in programme documentation, which promotes repeat borrowing on the basis of previous repayment record and ability to repay and also advocates that, in the first instance of taking a loan, households should be able to access only

5. Hancock, J. and Bauman, P. (2012) 'Stocktaking of Livelihood Projects in India. A Synthesis Paper.' Rome: FAO Investment Centre, Best Practices in Investment Design and FAO.

Box 2: Approaches when using informal groups to deliver credit for livelihoods

RaP: Individuals within Small Groups put together a business plan. The group assesses these and puts forward to the community Microfinance Subcommittee (MFS) those it thinks are viable and wants to be supported. The MFS assesses the record of savings and credit of the Small Group and negotiates terms and conditions of the loan with leaders of the Small Group. Loan documents are completed and the loan is disbursed. All members of the Small Group guarantee each individual loan, and there should be no requirement for collateral. The MFS, along with leaders of the Small Group, then follows up with the individual to ensure the loan is being spent for the reason for which it was approved. The MFS also follows up with group leaders on the matter of loan repayments. The MFS holds funds for individual livelihoods loans in a separate bank account and it receives these funds from the Village Development Organisation when they are released by the project.

PPAF: Community Organisations (COs) and/or Common Interest Groups (CIGs) can receive a one-off grant, equivalent to their total savings but not exceeding $200, from PPAF for on-lending within the group provided that they meet certain conditions. Eligible groups include those that have demonstrated savings over the past six months and a record of those savings; have revolving savings with a repayment rate of at least 95%; are registered and have a bank account for the CLF to be paid into; include women, the poor and the vulnerable; have developed Livelihoods Investment Plans that demonstrate that women will form a proportion of recipients of the CLF; and have mechanisms in place for on-lending of the CLF. The difficulties involved in community groups opening bank accounts have led PPAF to establish loan centres through which the grant injection is transferred and where group members place their savings.

a relatively small amount. The rationale here is that, if people repay a small loan, they are more likely to repay a larger loan. However, this may need to be questioned, as loan repayment is related not just to willingness to repay but also to ability to repay, and larger investments may have different risks attached compared with smaller ones.

- Difficulties exist in transferring an external injection of cash to the group. This often involves the group needing to open a bank account, which itself can be a challenge in FCS contexts with sparse financial services. Experience from Nepal's PAF highlights how care is needed when determining the rules and regulations around a group bank account, otherwise a few group members may end up making key decisions over accessing money.
- To a certain extent, credit-led groups are based on the belief that everyone wants to be an entrepreneur and to take credit in order to build a successful business. In particular, not everyone has the same level of risk-taking behaviour, or the same capacities to manage those risks. Experience from Pakistan's PPAF, though, shows how this is not the case; rather, the entrepreneurial outlook of groups and their members varies. Therefore, it offers different forms of support to groups it assesses as having different levels of entrepreneurial ambition.

3 The ladder of financial inclusion

For all of the case study programmes, promoting informal group-based financial services is intended as a first rung on the ladder towards financial inclusion. In other words, the groups are not an end in themselves and all of the programmes have activities and interventions that aim to build the possibility of developing more appropriate forms of financial services in the programme area. To achieve this, all programmes work on both ends of the ladder of financial inclusion: on the supply side (with formal financial institutions to change their practices) as well as the demand side (promoting responsible financial behaviour among poor households and reducing their poverty).

In tandem with promoting SGs, for instance, AREDP is also working on the supply side, with commercial banks and microfinance institutions, to increase access to, and improve the type of, financial products available. This is an acknowledgement of the limitations of SGs over the long term, but also that people require access to savings and credit in the short term, before over hopefully being able in the longer term to access formal financial services. AREDP has a third step on this ladder, promoting the federation of SGs into Village Savings and Loan Associations (VSLAs), which are just starting to receive seed grants from the programme. The programme then supports VSLAs with material and training to build their capacity and financial literacy to take advantage of commercial financial services. This is similar to the model adopted successfully in non-FCS areas of South Asia, where village-level associations receive seed and livelihood grants, which are then on-lent to savings and credit groups. They also pursue linkages and loans from formal financial institutions. However, forming VSLAs in Afghanistan has proven more difficult than the programme initially anticipated, given the difficulties involved in federating groups in areas of low population density as well as national banking requirements around opening a group bank account and then the programme transferring funds into it.

Under Pakistan's PPAF and Sri Lanka's RaP, meanwhile, it is a requirement to complete a business plan in order to access credit. Part of the rationale behind developing a business plan is to support people to develop the skills required in order to access loans from formal financial service providers in the future.

PPAF also has a rung on the ladder of financial inclusion that comes before microcredit and promoting informal credit-led groups. Initial experience from PPAF showed ultra-poor households were not able to benefit from credit, as this was spent on daily necessities rather than income-generating activities, and that ultra-poor people required grant-based approaches, through the one-off transfer of assets, in order to build their livelihoods first, before they could take a loan and join credit-led groups.

A key lesson from all of the programmes is the extensive time required to link poor beneficiaries with formal financial services. In each case, this has taken much longer than envisaged. In recognition of this, PPAF is supporting loan centres in some of the communities where it works. From the outset, these centres are required to develop a business plan and aim to be financially sustainable post-programme. In addition to transferring money for loans, groups also deposit their savings in these centres.

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