# BACKGROUNDER ON VSLA'S

Community-managed savings-led approaches to financial services for the poor have a long and successful history, particularly in India where there are over two million self-help groups (SHGs), serving 30 million members. More recently, community-managed approaches have proliferated in remote, rural regions in Africa and Asia. One such approach, Village Savings and Loan Associations (VSLAs), has been pioneered by CARE and has been successfully adapted by other agencies including Plan, Oxfam, Catholic Relief Services and the Aga Khan Foundation, reaching approximately two million very poor people in 22 countries.

VSLAs are self-managed groups that do not receive any external capital and provide people with a safe place to save their money, access small loans, and obtain emergency insurance. The approach is characterized by a focus on savings, asset building, and the provision of credit proportionate to the needs and repayment capacities of the borrowers. Groups are low-cost, simple to manage and can be seen as a first step for people to reach a more formal and wider array of financial services. VSLAs can dramatically raise the self-respect of individual members and help to build up social capital within communities, particularly among women who represent approximately 70 percent of members.

## CARE'S ROLE

The VSLA model was introduced by CARE in Niger in 1991. Since then, CARE has continued to innovate and adapt the methodology to accommodate flexible savings amounts and loans of variable lengths and sizes. By 2001, CARE had facilitated the creation of over 9,000 VSLAs with approximately 250,000 members in rural Niger, collectively amassing more than $14 million in savings. In 2007, over 87 percent of the 9,000 groups were still operating and studies indicate there are now well over 400,000 female members

## VSLA METHODOLOGY

Key elements of the VSLA approach include the following:

***Self-selection***: An external agency such as CARE, Oxfam or a local development organization introduces the concept of savings and loan services to the community and then facilitates the formation of VSLAs comprised by 15 to 30 persons. Because trust is fundamental to the effective functioning of a VSLA, members select each other to form their group.

***Training:*** Training is provided over a few months to help members define the VSLA's purpose, elect members to serve as officials, and set terms for savings and loans, including interest rates, repayment schedules and penalties for late payments or missed meetings. The group is also trained in a system to collect savings and make loans, record transactions, and run weekly meetings. The methodology offers recordkeeping techniques suitable for literate or illiterate people.

***Governance:*** Each VSLA elects a chairperson, secretary, treasurer, and two money-counters who form its executive committee. In addition, members select three others and entrust each with a key to one of the three locks on the cashbox where the group's funds are kept. This governance structure serves as an internal control system. All transactions –the collection of member savings and the disbursement of loans – are carried out at weekly meetings in front of all members, ensuring transparency and accountability.

***Financial Services*:** VSLAs begin by collecting weekly savings from members. Savings are accumulated in the form of shares at a price agreed upon by the group. The use of shares simplifies recordkeeping. Once sufficient savings have accumulated in the cashbox over four to five weeks, loans are offered to members. Typical loans range from $10 to $20. The group may set an interest rate for loans from around 5 to 10 percent monthly. At the end of the year, members receive a return on their savings ranging from 30 to 60 percent annually generated from interest and fees collected throughout the year. In addition, VSLAs set up an insurance fund, often called a social fund, to enable members to access money in emergencies or at particularly vulnerable times. The group determines if the emergency funds are distributed as grants or as interest-free loans with flexible repayment.

***Audit:*** Some nine to twelve months after the VSLA is formed, the group conducts an "action audit" whereby it pays out savings and earnings from interest and fees, closes its books, and disbands. The action audit is usually timed to provide a lump sum to members at critical times in the year when access to money is needed, for example to pay for school fees or inputs at the start of the agricultural season. It also enables members to leave the group and new members to join. Most groups reconstitute themselves and resume the savings and loan process.

***Agency facilitation:*** From the start of the VSLA's operations to the time of the first action audit, the agency observes its meetings and supports the executive committee as needed to ensure that procedures and systems are working well. If there are no issues, the group functions independently thereafter.

## COMPLEMENT TO MFIS

VSLAs are complementary to MFIs. They serve people living in remote places whose income is low and irregular, need to save cash in small amounts, and have limited demand for credit because markets for their products are weak. Such populations are costly for MFIs to serve. Through VSLAs, some community members may build up their assets enough to be attractive clients for MFIs, credit unions and banks. There is growing recognition of the importance of VSLAs as an entry-level component of a vibrant financial system. CGAP recently completed a study of 60 community-based projects worldwide and concluded that autonomous, community-managed programs, such as VSLAs, have superior portfolio quality compared to those which receive external capital.

### STRENGTHS

- *Rural and poverty outreach*: Groups can operate in remote or sparsely populated areas where more formal financial services are not cost-effective or available.
- *Low operating costs:* VSLAs avoid most of the infrastructure, transport, communications and personnel costs incurred by a MFI. Cost per member for the startup of VSLAs ranges in Africa from $20 to $60; in Asia, from $10 to $20.
- *Capital remains within group:* Interest paid on loans remains within the group, and builds the cash assets of the members.
- *Transparent, democratic and flexible:* Members determine their own rules and decisions are made through consensus with minimal paperwork. Members save on a flexible schedule agreed upon by the group and can vary the amount saved each period. Because members usually know each other well, there is more flexibility in offering quick loan disbursement and individualized repayment schedules.
- *Client debt level:* Loans are matched to each member's capacity to repay, based on the group's decision.
- *Conduit for other interventions:* Some agencies use groups to provide other services such as health education.
- *Opportunity for increased economic activity:* VSLAs can be seen as a first step in financial access. While some groups will never link to the formal financial system, others will leverage their learning about financial services in the group context to seek access to more formal and a wider array of financial services.

### CONSTRAINTS

- *Limited capital:* Since VSLAs depend on members' limited savings capacity to provide the group's lending capital, loan demand by members can outpace supply.
- *Limited product offering:* Without a linkage to a formal financial institution, products within the group are limited to simple forms of savings, loans and insurance that may not match well the needs of all members.
- *Interrupted savings:* The yearly distribution of savings and caps on shares interrupt members' efforts over time to accumulate large amounts of capital (although at the first meeting when the group reconstitutes, savings can be reinvested at five times the normal weekly amount).
- *Elite capture:* More powerful group members can exploit the loan fund by taking more than their share of loans and by defaulting. A way to mitigate this has been to place a cap on the number of shares (savings) which can be purchased by any one member and by restricting loan amounts to multiples of shares held.

- *Exclusion:* Since groups are self-selecting, there is a risk that members of the community will exclude poorer individuals from groups.
- *Theft:* Cashboxes are maintained by the groups and may pose a risk of theft. In practice, with the exception of the first few weeks when groups start to save and the last months when loans are being repaid, the cashbox is nearly empty as funds are circulating among the members. To minimize risk, groups can be linked to banks which allow the groups to maintain savings accounts, particularly during the last few months prior to the action audit.

### Opportunities for Innovation

Several opportunities for innovation have been identified which, if addressed, would spur scale up of financial services to the poor.

- *Linkages to formal financial institutions*: Over time, some members may need more diverse financial services and/or larger loan sizes which cannot be met by VSLAs due to the limitations outlined above. Agencies have piloted linkages with formal financial institutions such as banks, MFIs and credit unions in response to the demand for a broader range of services, however they must further address concerns of increasing costs to VSLAs (service fees, travel costs, etc.), creating over indebtedness, or otherwise destabilizing the group.
- *Income Generation:* While VSLAs have been tremendously successful in poverty reduction and income smoothing, there are opportunities to enhance the opportunity for income generation and asset building.
- *Sustainability and quality:* A challenge to rapid scale up is the sustainability and quality of services of VSLAs once they become independent. Some agencies are testing models whereby field agents based in the region provide scheduled monitoring for a fee paid by the group. Another experiment promotes VSLAs to form credit unions and other larger registered bodies that can provide support, such as negotiating fees with banks and assuring quality standards.
- *Building institutional linkages:* Agencies can help VSLAs leverage their social capital and organizational capacity to link into agricultural development efforts, health and education.

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