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Savings and Needs in East Africa: An Infinite Variety

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Executive Summary

The poor save for a variety of reasons, most of which have underlying risk protection and risk management dimensions. Risks are factors beyond the control of the affected individual or household. They temporarily or permanently disrupt the functioning of the household economic portfolio to such an extent that the income stream required to fulfil the household's basic needs can no longer be maintained. The poor use different strategies to manage different risk factors. It is therefore of utmost importance that microfinance institutions analyse and understand these differences to be able to design products and service delivery structures that are appropriate to the risk management needs of poor people.

Rahman and Hossain (1995) offer a framework for analysing risk that considers the extent to which a specific disruption can be anticipated, and hence planned for, as well as the degree to which these disruptions affect the choice of responses. These risks interact to form a complex risk environment, and give rise to a complex range of risk management strategies. These strategies can be broadly grouped into precautionary strategies and response/loss management strategies. *Precautionary or risk reduction strategies* are intended to reduce the household's risk exposure. *Response/loss management strategies* are intended to reduce the impact after the loss has occurred. There are a variety of risk management strategies employed by the poor in the East African countries of Tanzania, Uganda, and Kenya. These include investments in human, physical, financial and social assets. It is the objective of this report to assess the financial needs of poor communities in East Africa, and to evaluate existing programs in order to determine potential savings products that not only address those needs but address those needs in a manner best suited to the capabilities and desires of the targeted communities.

What Risks Do the Poor Face?

Life-cycle Risks

Life-cycle risks are related to such events as marriage, birth, education, healthcare, homemaking, widowhood, old age, death and the need for an inheritance for one's heirs. Most life-cycle risks have a degree of predictability that makes planning and managing them somewhat feasible. However, these life-cycle risks can become or generate crises if they are not adequately planned for and insufficient savings have been accumulated to manage them. ***MicroSave*** found that there are typically four overwhelming life-cycle events that require relatively large amounts of money: wedding ceremonies, secondary and tertiary education, prolonged illness and the death of a spouse.

Structural Risks

Structural risks tend to be long-term, cyclical or permanent changes in the national or international economy. In East Africa, as in many other developing regions, some of the most conspicuous structural factors are strongly linked to the implementation of governments structural adjustment programmes, and seasonal factors that affect income and expenditure. In East Africa many micro-businesses suffer from instabilities caused by seasonal variations in income and expenditure.

Crisis Risks

Crisis risks are sudden, unexpected shocks to the household that disrupt its ability to generate income. They demand emergency interventions. They require the adoption of either short- or long-term strategies that may include the sale of productive assets or a permanent downward revision of the household consumption budget. Short-term coping strategies enable the household to manage the immediate stress situation before it can resume functioning at its pre-crisis level. Illness or the premature death of major bread earner, fire, accidents, thefts and cheating were frequently mentioned as triggering crises in East Africa.

Responses to the Needs

Successful financial service provisions and innovations are dependent upon understanding and responding to client needs and preferences. This can only be achieved by understanding the client's complex risk environment as well as the strengths and weakness of their current coping mechanisms.

Responses of the Informal Financial Sector

Responding to Life-cycle Risks

Life-cycle risks normally require immediately available, large amounts of money and therefore require the fore thought and discipline of a regular saving regime. Although savings in-kind and saving-at-home seem to be the most prevalent, RoSCAs (Rotating Savings and Credit Associations) are enjoying exponential growth in all three East African countries. Except for the RoSCAs and ASCAs (Accumulating Savings and Credit Associations), no other savings mechanisms provide the kind of discipline needed to make regular savings. While ASCAs provide a mechanism for disciplined saving, they require extensive accounting skills to track savings and credit transactions, thus making ASCAs inappropriate for most of the poor who rarely possess these skills. Self-help group emergency funds are increasingly popular especially among people in urban areas where they are organised by ethnic lines, location or areas of origin. An increasing number of shopkeepers in urban centres are willing to take deposits on household durables and building materials which the buyer takes upon full payment. This enables the poor to assemble a lump sum of money to acquire such things as domestic durables, to construct one's own home, and to acquire productive assets when opportunities arise.

Responding to Structural Risks

In case of structural risk caused by seasonal fluctuations, the informal sector tends to extend financial services especially where the potential for repayment can be established. The financial management strategies include reciprocal lending, savings-in-kind, RoSCAs, ASCAs, savings clubs, emergency funds, moneylenders and pawnbrokers. With long-term structural risks, the financial management strategies change as the crisis assumes a longer-term nature. The strategies move from reciprocal short-term borrowing in the early stages to liquidation of assets as the risk advances to longer-time periods.

Responding to Crisis Needs

Crisis risks require products or services that are liquid and easily accessible. Home savings, reciprocal lending and self-help emergency funds are the most frequently used mechanisms for responding to crisis risks. All of these have varying degrees of accessibility. Less prevalent, though by no means insignificant, are part-time, commercial moneylenders and pawnbrokers. Sometimes the poor liquidate assets to finance crisis risks. Many of these money schemes are run as an adjunct to RoSCAs. Many ASCAs are beginning to consider the importance of addressing the pressures associated with clients making weekly loan repayments to MicroFinance Institutions (MFIs) during crisis situations and can be a source for emergency loans.

Responses of the Semi-Formal Financial Sector

The semi-formal financial sector includes those organisations that are legally registered but not under the regulation and supervision of the Central Bank. They include NGO-MFIs, SACCOs, and community healthcare financing schemes.

Most MFIs in East Africa extend only working capital loans with an emphasis on lending to existing women-owned businesses that are older than one year. Existing laws bar MFIs from accepting savings deposits and therefore are limited to offering credit services only. This limited range of financial services is incapable of meeting their risk management needs. More recently some MFIs have started examining health and life insurance schemes with the idea that insurance plans offer a savings type security in cases of illness and death.

Preliminary Ideas For Innovation

The following are brief descriptions of potential s product innovations that still require scrutiny, testing, refinement, and pilot testing before they are finally commercialised. Most of them are based on ideas and current practices in the informal sector.

Financial Products to Address Life-cycle Risks

University and Post Secondary Education Saving Product

This contractual savings product, like RoSCAs and ASCAs, would require the account holders to commit themselves to contributing a given amount on a periodic basis for an agreed upon period of time. This could be weekly, or bi-monthly or monthly.

University Education Bond

This lump sum investment of modest amounts would be held for two to fifteen years in order to obtain the maximum benefit, possibly with an option of making early withdraws with a penalty. The maturity of the bond would be designed to coincide with the number of years left before the student graduates to post secondary school or university.

Fixed Deposit Savings Product

This is a periodic, variablefixed deposit savings product for people interested in locking money away for schools fees during the peak income seasons especially after the sale of cash crops or an animal.

Education Contractual Savings Product

Small periodic deposits are put into an account similar to the rhythm of the RoSCA. This is most appropriate where savers have a fairly smooth flow of income with minimal seasonal variations. The term of the deposit corresponds to the school term.

Home Ownership Savings Product

This contractual savings product would require small, periodic deposits over an extended period of time depending on the price of the house

Wedding Festivities Savings Products

This is another contractual savings account that would require small, periodic deposits until the money is needed for paying for wedding festivities.

Funeral Expenses Savings Product

This product, designed as a contractual savings account, would require small, periodic amounts until the client is satisfied that they have sufficient resources to cover the risk.

Old Age/Retirement Savings Products

This is another contractual savings product that could be designed such that, at the end of the contract, clients would receive a lump sum of money or would be able to draw on the account while the balance continued to earn interest.

Start-Up Capital Savings Products

This contractual savings account could require flexible contributions with restrictions on withdraws until a pre-determined period has passed. The scheme allowing for flexible contributions is in response to the fact that students may not be in position to make regular equal contributions since they tend to depend on the generosity of parents, relatives and friends.

Group Savings Products

MFIs could consider promoting RoSCAs so that whoever gets the lump sum brings it to the banks or MFI. This means that the bank will only have to deal with one person with a relatively large amount of money instead of many people, each with small deposits. Another target for the group savings product could be social groups that regularly meet for some purpose.

Financial Products in Response to Crisis Risks

Healthcare Insurance/Savings Product

Although illness is the most often mentioned crisis factor, seasons of greatest illness can often be predicted and the associated expenditure pattern can be established. This degree of predictability makes it possible for individuals to plan for the illness. In one community, residents suggested that an emergency loan to address the need cover health expenses would meet a critical need. The emergency loan, it was suggested, would be secured by the education fixed deposit product especially since the season with the high incidence of illness comes about two months before the beginning of the school term for which the education savings are held.

General Emergency Loan Product

This can be designed such that individuals who have savings (especially the contractual savings product) would be eligible for an emergency loan and would not be forced to break the contract and lose the corresponding benefits or disrupt future plans. This loan should be disbursed rapidly, as is appropriate for emergencies, because it would be guaranteed 100% by the savings.

Service Delivery Innovations

Taking the Service to Poor and Accepting Small, Regular and Frequent Deposits

One of the most cited and highest ranked attributes of financial services among the poor was proximity of the financial service- the closer the service, the lower the transaction costs. This is partly why formal banks are not very popular with the poor and helps to partly explain the popularity of the RoSCAs. For this reason, MFIs should consider approaches for taking services closer to the poor. Ideas may range from using mobile human tellers to introduction of ATM (automatic teller machines)

Conclusion

The risk environment and the demonstrated need for savings among the poor present an infinite variety of potentially profitable and mutually beneficial possibilities for both the micro-clients and microfinance institutions. The key is to pay close attention to the micro-clients' needs, current financial coping mechanisms (which are usually in the informal sector), constraints of the current coping mechanisms, and important issues. Along with the clients situation the ability of the organisation to earn a profit while providing client suited, viable and reliable services must also be evaluated.

East African MFIs need go beyond the limited group-based micro-enterprise credit. They need to experiment with new products and strengthen their product development capacity to produce micro-financial services that meet client needs and justify levying surcharges that permit sustainability and profitability. In addition, this will enable MFIs to increase the breadth and depth of their outreach. Those MFIs that extend and expand their services will be taking a risk. Those that do not will be history.

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Introduction

> "*The poor are largely excluded from formal providers of 'basic' intermediation service and are left to invent and manage their own service, or pay high prices to people willing to offer them on an informal basis*" (Stuart Rutherford, 1997).

Everyday the poor face various types of risks for which they manage by calling upon their physical, social, human and financial resources (Wright et al 1999). The poor save for a variety of reasons, most of which have underlying risk protection and risk management dimensions. *Risks* are factors beyond the control of the affected individual or household. They temporarily or permanently disrupt the functioning of household economic portfolios to such an extent that the income stream required to fulfil basic household needs can no longer be maintained. This paper seeks to provide an overview of the risk factors facing the poor in East Africa and the financial management strategies they use to protect themselves against or manage the realised risks by using savings. Further, this paper explores the savings mechanisms that are available to the poor. Finally, this paper explores the various preliminary ideas of products that can be designed and offered to the poor to address the risks they face. A lot of the product ideas borrow heavily from informal sector mechanisms.

What Risks Do the Poor Face?

Rahman and Hossain (1995) offer a framework for analysing risk which examines the extent to which a specific disruption can be anticipated and hence planned for, and extrapolates the degree to which these disruptions affect the choice of a response strategy.

In this framework, risks are organised as follows:

- life-cycle risks,
- structural risks, and
- crisis risks.

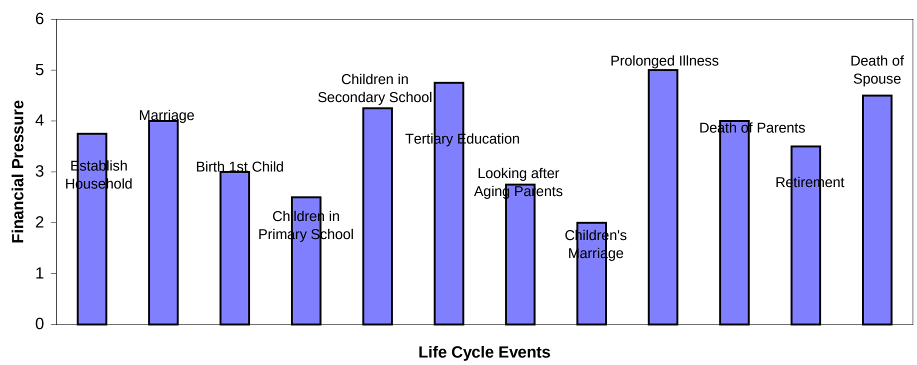
These risks interact to form a complex risk environment, and give rise to a complex range of risk management strategies. These strategies can be broadly grouped into precautionary strategies and response/loss management strategies. *Precautionary or risk reduction strategies* are intended to reduce the household's risk exposure. *Response/loss management strategies* are intended to reduce the impact after the loss has occurred. There are a variety of risk management strategies the poor employ. These include investments in human, physical, financial and social assets. This paper will only examine financial management strategies with particular focus on savings as a risk reduction or a loss management strategy. This paper examines the three categories of risks before looking at how savings are used as a risk management strategy. The risks will be discussed in order of frequency within poor households: life-cycle, structural and crisis risks. Risk categories are not mutually exclusive. They are often overlapping and frequently related.

Life-cycle Risks

Life-cycle risks are related to such events as marriage, birth, education, healthcare, homemaking, widowhood, old age, death and the need to leave an inheritance. They tend to have a certain degree of *predictability* that makes planning and managing them at least somewhat feasible. Regular savings are important for financing life-cycle events because such events often require substantial sums of money, often with short notice. However, these life-cycle risks can become, or generate, crises if they are not adequately planned for and insufficient savings have been accumulated to manage them.

MicroSave used Life-cycle Profile PRA techniques (Wright et al., 1999a) in a variety of settings to analyse what life-cycle needs East African poor face during different stages in their lives. The chart below illustrates the results from four women groups consisting of women primarily between the ages of 26 and 40. As demonstrated in the graph, there are typically four overwhelming life-cycle events that require relatively large amounts of money. These are wedding ceremonies, secondary and tertiary education, prolonged illness, and the death of a spouse. Of course, as a result of socio-cultural norms and other local factors, there are serious variations among different groups and areas of East Africa in terms of life-cycle events that demand relatively large lump sums of money. This stresses the crucial need for local market research by MFIs to determine client needs in different areas of operation so that appropriate products and promotional strategies are designed and adopted.

Figure 1. Graph: Life-cycle Events and the Relative Need for Lump Sums.



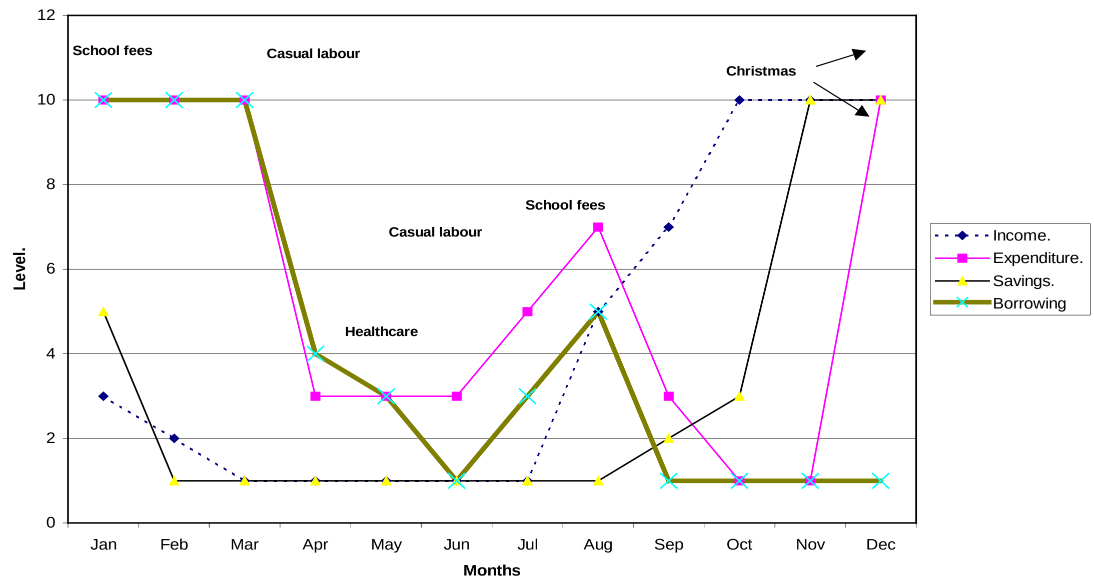
Structural Risks

Structural risks tend to be long-term or permanent changes in the national or international economy or cyclical events that affect the economic conditions. In East Africa, as in many other developing regions, some of the most conspicuous structural factors are strongly linked to the implementation of structural adjustment programmes, (macroeconomic stabilisation followed by the liberalisation of prices and markets) and seasonal factors that affect income and expenditure.

The impact of structural adjustment related policies have been significant and multi-directional. While on one had, the freeing up of prices and markets have created new opportunities for private sector economic activities, the continued downsizing by government and reduction of basic services such as healthcare has had profound impacts on poor households. A number of poor households have lost an important stable income source. This has forced many to start micro-businesses, take on more jobs, migrate to distant lands, remove children from school, and send children to villages in order to adjust to the challenges created by the lost income.

Several seasonality Participatory Rapid Appraisal exercises with the poor in various parts of East Africa reveal that many of the micro-businesses suffer from instabilities caused by seasonal variations in income and expenditure. Many of the trading and retailing activities generate the highest returns around Christmas (October, November, December) often leaving business and household severely cash strapped for the other months of the year. In absence of savings this pattern exposes households to severe risks especially in the areas of health care and education related expenses. This seasonality is even more pronounced in rural areas, which usually has a spill-over effect into urban areas.

Figure 2. Seasonality of Inome, Expenditure, Savings and Credit in the Farming Community of Moshi, Tanzania.



In the community illustrated in Fig. 2, the last of part of the year has great savings potential because there is plenty of income in excess of expenditure. According to the residents, the community tends to save in-kind by purchasing livestock that can be sold at a later day date or used as collateral. However, in the absence of a better alternative, a large proportion of the seasonal income is spent on frivolous expenses associated with the Christmas season. The savings are needed to finance farm labour for preparing farms for planting and weeding during the month of May and for harvesting in the month July. Savings are also used to finance health care mainly during the months of April, May and June which have a high incidence of malaria and pneumonia. School fees are also due during the month of. The other common methods of accumulating large sums of money include SACCOs, RoSCAs, saving at home and friends[1].

The month of July can be particularly hard especially for people who did not save because it comes after a season of typically high health care expenses which is immediately followed by school related expenses and harvest expenses just before the high income season begins. At this time, as in early January, most people resort to borrowing. The sources of credit are principally reciprocal borrowing arrangements, but also include part-time commercial lenders who on average charge 20% per month. The average loan size encountered in ***MicroSave's*** research was approximately US$150.

Crisis Risks

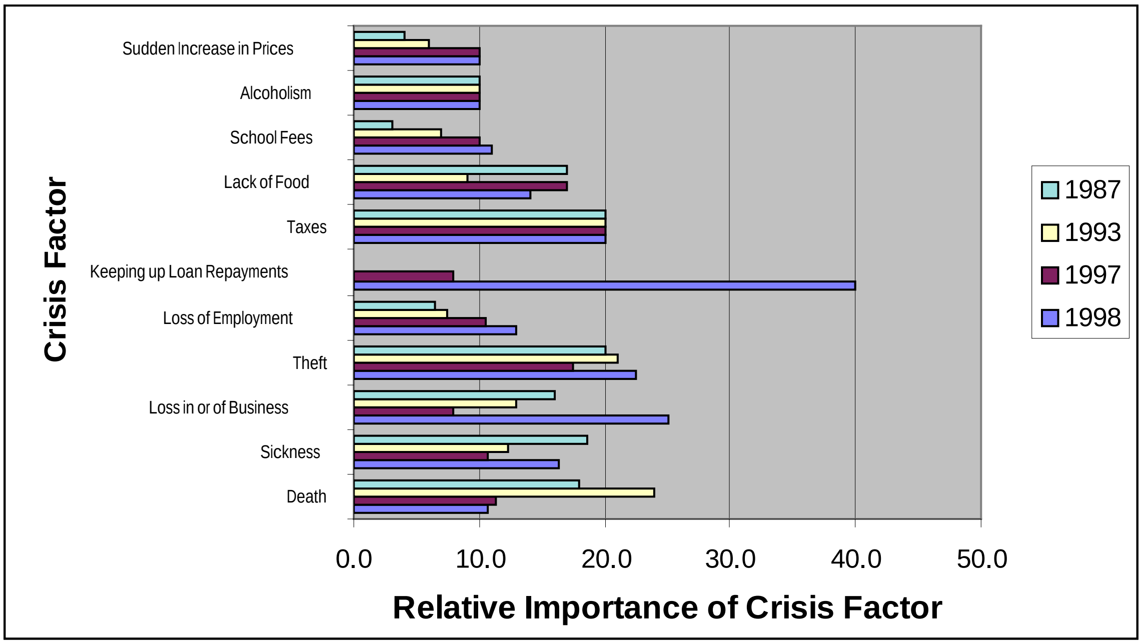
Crisis risks are sudden, unexpected shocks to the household that can disrupt the households' ability to generate income. Oftentimes crises are a result of poor planning of life-cycle events or lack of safety nets in the face of structural risks. They demand emergency interventions. This generally requires the adoption of either short-term or long-term strategies that may include the sale of productive assets or a permanent downward revision of the household consumption budget. Short-term coping strategies get the household through the immediate stress situation before it can resume functioning at its pre-crisis level.

[1] A detailed discussion of the various savings mechanisms used by the poor in East Africa is found in "Savings and the Poor – The Methods, Use and Impact of Savings by the Poor of East Africa" by Stuart Rutherford (1999).

Research among households affected by crises revealed a long list of such shocks. Illness or the premature death of major bread earner, fire, accidents, thefts and cheating were frequently mentioned as triggering crises. The economic and social costs associated with such a shock tend to be enormous. Not only do they generate considerable expenditure, but they can also lead to a permanent loss of revenue for the household if the major productive assets and/or main bread earner is affected. It was noted that women are particularly vulnerable after losing or being abandoned by their husbands, compounded by the associated loss of status. Households with savings tend to fair better than those without savings.

Figure 3 illustrates the relative importance of crisis factors among some clients in Kampala. This example shares a lot of similarities with other areas in East Africa, and demonstrates the possibilities for innovative product design and marketing strategies. This subject will be discussed further in the last part of this paper.

Figure 3: Crisis Factor Over Time As Described by the Ugandan Women's Finance Trust



Responses To The Needs

Successful financial service provision and innovation is based on understanding and responding to client needs and preferences. This can only be achieved through understanding the complex risk environment of the clients and the strengths and weakness of the clients' current coping mechanisms. This section will discuss the various ways in which the informal, semi-formal and the formal sectors assist the poor respond to the crisis, life-cycle and structural risks they face. In East Africa, and indeed a lot of other regions that share similar economic and social characteristics, the informal sector enjoys the largest share of the market for financial services for the poor. (Aryeetey et at 1991). This paper will focus mainly on the informal sector and to a limited extent on the semi-formal sector. Apart from the Post Office Banks, which, to varying degrees serve the poor in all three East African countries, the formal sector plays an insignificant role in terms of providing financial services to the poor (Rutherford, 1999, Lwoga, 1999, Mutesasira, 1999, Mugwanga, 1999, Bagachwa, 1995). It is for this reason that this paper will not dwell on the formal sector.

The last section of this the paper focuses on possible responses to the needs drawing lessons and adopting practices from the poor people's current coping mechanisms.

Informal Financial Sector Responding to Crisis Needs

Research across East Africa[2] produced a list of the most prevalent crisis risks (see figure 3) They include sudden loss of employment, illness, death, , business losses, theft, lack of food, alcoholism, divorce, separation etc. Although the severity of impact varies from one place to another within East Africa, some of the most consistently and frequently cited crises are illness, death and loss of employment. The severity of the crisis tends to be correspondingly greater where there is an absence of savings.

Therefore, in order to minimise the impact of the risk, the poor accumulate savings or seek financing through a variety of financial devices. This paper will not discuss these financial mechanisms at length since they are adequately covered in other studies (Rutherford, 1999; Mutesasira, 1999, Mutesasira, 1999a, Mugwanga, 1999). However it will discuss the generic products offered in the informal sector and their strengths and weaknesses in responding to crisis factors.

Crisis risks require products or services that are liquid and easily accessible. Based on the research conducted so far, savings at home, reciprocal lending and self-help emergency funds are the most frequently used mechanisms for responding to crisis risks. These savings mechanisms have varying degrees of accessibility. Less prevalent, though by no means insignificant, are part-time commercial moneylenders and pawnbrokers.

Sometimes the poor liquidate assets to finance crisis risks. Cases of this were reported in the very poor Kampala slums where MFIs have been reluctant to extend financial services (Rutherford, 1999). The difficulty is that when in need of quick money, the assets tend to be sold at much lower than market or cost value. In some cases, people have pawned their assets. Although this provides immediate access to cash, this source of finance tends to be extremely expensive because the terms are usually unfavourable. Apart from the very high interest often charged on these short term loans (20-30% for a week or two), the borrower often loses the assets because of failure to repay a loan that is as low as 30% of the asset value.

Another source of emergency loans is ASCAs (Accumulating Savings and Credit Associations), many of which are run as an adjunct to RoSCAs. ASCAs are also assuming increasing importance in addressing the risks and pressures associated with making periodic loan repayments to MFIs. A growing number of ASCAs are built within MFI clients groups. If an MFI client is unable to make the payment and places the group's savings are at risk (and the member is in danger of being forced out of the group) the group's ASCA will be used to make a loan to meet the weekly repayments. These loans tend to be one to two weeks at interest rates averaging 5% per week (Rutherford, 1999, Lwoga, 1999). However, because ASCAs require a certain level of accounting skills and a reasonable level literacy, both of which are usually lacking among the poor, they tend to be fraught with management problems. This often leads to financial losses, a loss in member confidence, and eventually, the ASCAs are forced to close-down. Nonetheless, given the role they play in protecting the quality of the loan portfolio, MFIs might do well to invest in their promotion.

Another important source of financing for crisis risks in some areas is commercial moneylenders[3]. They normally extend short-term loans ranging between 5% to 30% a month. The loans are usually used for paying school fees, medical expenses and hiring labour for harvesting. Most reports (Rutherford, 1999, Lwoga, 1999, Mugwanga 1999 and Mutesasira, 1999a) suggest that there are very few moneylenders in Tanzania. However, Bagachwa (1995) suggests otherwise noting that, "The relatively low profile allegedly assumed by moneylenders in channelling credit could be a camouflage, reflecting in part the traditional view that commercial lending is exploitative… Given the rather hostile environment…most moneylenders do not admit to engaging in this practice. Therefore, their number and their roles tend to be underestimated."

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[2] *See* ***MicroSave's*** website: http://www.*MicroSave*.net for the full range of the studies

[3] One area where they were prevalent is Machakos, Kenya where they are referred to as *Chailok* (which seems to be a transliteration of the of Shakespearean "Shylock")

Commercial Moneylenders In Dar-es-Salaam

"There are no full-time moneylenders in this that we know of," says the Ward Executive Secretary in Manzese slums of Dar-es-Salaam, "There are however traders who lend money to people they know very well with interest of between 10% and 30%. They do not require collateral. Sometimes the borrowers fail to repay the loans and the traders (lenders) bring them to the Ward Office where the cases are settled. Our office receives about two such cases per month."

In spite of its limitations and sometimes significant disadvantages, the informal sector plays a significant role in financing crisis risk situations. The vibrancy of the informal sector reflects its responsiveness to clients risk management requirements. These include easily understood procedures, flexible lending arrangements, the absence of restrictions on how loans are used, credit at short notice, limited or no paper work, proximity to borrower and local adaptability. Finally, informal financial institutions face relatively low transaction costs. Due to strong local knowledge and social pressure, there are extremely low costs for assessing the borrower's creditworthiness and collecting loans, (Bagachwa 1996, Rutherford 1999, Mutesasira 1999a).

Informal Financial Sector Responding to Life-cycle Risks

Life-cycle risks normally require large amounts of money within a relatively short time and therefore require regular savings, which in turn require disciplined saving behaviour. The informal sector provides several devices for assembling lump sums of money through regular periodic contributions (Rutherford, 1999). The most common ways to build a lump sum include saving at home, RoSCAs[4], savings clubs, ASCAs, deposits with suppliers and savings-in-kind. Although savings in-kind and saving at home seem to be the most prevalent, RoSCAs are enjoying exponential growth in all three East African countries.

Except for RoSCA and ASCAs no other savings mechanisms promotes and require the kind of discipline needed to make regular savings deposits. The system of regular deposits, and thus growing savings in addition to a member validating system, is perhaps one of the most credible explanations for the exponential growth and popularity of RoSCAs. This validating system or "action audit" (Rutherford, 1999), gives the members the power to acknowledge the success or failure of a RoSCA. Members use a built-in termination scheme at the end of each cycle, to decide whether they wish to continue and start another cycle or stop. In short, it provides a periodic quality control check. While this action audit allows a time to review and decide whether to continue the scheme, it also means that these schemes can only function for a limited duration thus prohibiting longer-term savings. ASCAs also provide the mechanism for disciplined savings. However, the need to have reasonable accounting skills to track the savings and credit transactions makes it inappropriate for the large percentage of illiterate poor who are particularly vulnerable to manipulation by dishonest individuals.

Self-help group emergency funds that are organised around ethnic lines, location or areas of origin are enjoying increased popularity[5] especially among people in urban areas. The most common need financed by the self-help groups is funeral expenses. Increasingly though, they have added other needs including celebrations like baptism and weddings. The self-help groups tend to be organised especially by the upper-poor and middle class, although in some areas they cut across classes.

[4] ROSCAs go by various names in East Africa. These include *upatu, kibati, mchezo,* merry-go-round, cash round, *kalulu* etc
[5] These are called *munno mukabi* (which means "friend in need associations") in Uganda, *bursary clubs* in Nairobi and a variety of names in Tanzania

The Emergency Fund

Mary, a low wage earner in Dar-es-Salaam, belongs to an informal insurance group organised along ethnic lines mainly to cover funeral related expenses. This is extremely important especially for people like her who have to transport their dead to distant areas of the country. The group has approximately one hundred members. Every member contributes Tsh.10,000 per month and is then assured of financing in the event of a funeral or a celebration within their immediate family. A thorough background check is made on prospective members to establish their character. “It is very important to get a decent burial in my tribe,” says Mary. “ This means taking the body to all the way to Moshi. That is why I joined the group so that just in case of an emergency, I have a source of money and people to help me. Her group also provides emergency loans to members at 5% per month.

An increasing number of shopkeepers in urban centres are willing to sell household durables and building materials on credit given a sizeable deposit. This enables the poor to assemble a large sum of money to manage life-cycle events such as homemaking, construction of one’s own home, and opportunities to acquire productive assets. This device, though useful, has its limitations because it calls for trusting the shopkeeper in a contract that may not be legally enforceable, or if it is, might take a lot of time and money in the event of a dispute. The other limitation is lack of the kind of discipline found in the RoSCA or ASCA, although this is somewhat compensated by the desire to complete the payments and take the asset home once one has started. This not only allows one use of the assets but also reduces one’s risk exposure.

Deposits With A Shop-Keeper in Dar-es-Salaam

“One of the increasingly common ways to acquire a TV, music systems, beds, mattresses and other consumer durables is by making a cash deposit with a shopkeeper. I acquired my TV by making four deposits at a shop before I could pay up in full to take the TV home. I used part of my salary and sometimes the proceeds from one of the *upatus(RoSCAs)* I belong to. In about 3 months, I had a TV in my house. This method of saving for consumer durables is increasing in popularity.” Asked whether she sensed a risk in depositing money she responded, “Of course there are risks depending on which shop you go to, however, there are shops that have a good reputation. They give you a receipt indicating the deposited amount and the outstanding balance on the item. This works well and I have not heard any complaints.” This method is reportedly used by micro-entrepreneurs to acquire productive assets like refrigerators, sewing machines, pop-corn machines, etc.

Informal Financial Sector Responding to Structural Crisis

As indicated earlier structural risks tend to be long-term or permanent changes in the national or international economy. In East Africa, as in many other developing countries, some of these structural factors are strongly linked to the implementation of structural adjustment programmes, which included government divestiture, retrenchment, privatisation, and liberalisation. Structural factors also include the seasonal fluctuations in income and expenditure, and fluctuating commodity prices that characterise most predominantly agricultural economies.

Structural risks that lead to loss of employment tend to be harder to deal with because the informal credit sector is unlikely to lend sufficient amounts to the unemployed while they look for work. In the end, those affected tend to cope by liquidating their assets, depending on charitable contributions from friends, downwardly revising household consumption budgets, withdrawing children from school, and in some cases, migrating back to the rural areas (Wright et al, 1999).

In case of structural risks caused by seasonal fluctuations, the informal sector tends to extend financial services especially where the potential for repayment can be established. The financial management strategies include reciprocal lending, savings in kind, RoSCAs, ASCAs, savings clubs, emergency funds, moneylenders and pawnbrokers. With long-term structural risks, the financial management strategies will change as the crisis assumes a longer-term nature. The strategies will move from reciprocal short-term borrowing in the early stages to liquidation of assets as the risk advances to longer-time periods.

The Semi-Formal Sector Responding To Needs

Semi-formal financial sector includes those organisations that are legally registered but not under the regulation and supervision of the Central Bank. They include NGO-MFIs, SACCOs[6], and community healthcare financing schemes.

Most MFIs in East Africa only extend working capital loans with an emphasis on lending to existing women-owned businesses that are older than one year. Existing laws bar MFIs from accepting savings deposits. With the exception of clients who find the diversion of loan funds a strategic imperative, this limited range of financial services is incapable of meeting most risk management needs. More recently, some MFIs, including FINCA Uganda and K-REP have started pilot testing health and life insurance products. The example from the Presidential Trust Fund's (PTF) *kibindo system* (see box below) provides an example of how MFIs might assist clients to develop their own flexible savings mechanisms. These are mechanisms that could be used to generate lump-sums of savings that could be captured by the MFI when and if they are allowed to offer savings services.

Kibindo - Lender of Last Resort

The *kibindo* system, which translates to "lender of last resort" is an ASCA organised within an MFI client group, which is typically 40 members. It is found mainly among PTF members. All PTF groups have a *kibindo* and these are managed and controlled by the members themselves without assistance from PTF. The most common weekly contribution to a *kibindo* is Tsh.500[7], with a range from Tsh.200 - Tsh.1,000. Members take loans from *kibindo* which range from Tsh.5,000 to Tsh..50000 at a 5% weekly interest rate repayable in three weeks. *Kibindo* fund is distributed to the members at the end of the loan cycle according to contributions. In an average cycle, about 10 members out of 40 members in the centre will take a loan from it with some members taking more than once.

The *kibindo* is thus very good for both the MFI and the clients. It acts as a short term saving device and as a short-term emergency loan facility. It helps the members to deal with pressing financial problems. It is also used by the groups to pay loan instalments for a member who fails to meet their repayment.

The major risk with the *kibindo* is that it is based on trust; an individual, designated as treasurer (popularly referred to as *Mama Kibindo*[8]) keeps the money in her custody, keeps records of deposits, loans and interest paid by each loanee, a job that is often come with book-keeping challenges in pre-dominantly semi-illiterate segments of society.

Other community/member-based organisations such as SACCOs in East Africa have a mixed record of success, with the strongest SACCOs found in Kenya and the weakest ones in Uganda. SACCOs provide opportunities for savings, borrowing, dividends and loan insurance products. Well run SACCOs, of which sadly there are few, provide valuable savings opportunities and enable members to build a reserve available during times of need.

Another form of community/member-based organisation that attempts to address some of the short-comings of SACCOs are Financial Service Associations (FSAs). In Uganda and Kenya village-based FSAs provide invaluable savings and credit services to their members. FSAs are user-owned and managed institutions that offer emergency as well as business loans and open access savings services. The savings services are so popular that the members pay 3% on each deposit in order to be allowed to save with the FSA. Clearly these services play an important role preparing for the risks that the members face.

Poor health is one of the leading life-cycle risks that most households mentioned during the research in the three countries. The potential of high healthcare costs has become a more acute risk to the poor since the

[6] This includes FSAs run by PRIDE Uganda and K-REP
[7] Exchange rate: Tsh. 700 = $1
[8] translates to "Mother of *Kibindo*"

introduction of cost sharing and full cost recovery in health centres and hospitals. The semi-formal sector has responded by developing and piloting community based healthcare insurance. This is currently being tested by a variety of institutions including MFIs and community based organisations in all three East African countries.

An example is the Kisizi Hospital Healthcare Association in Uganda. It has over 6,000 member[9] households each averaging 6 people. Non-motorised ambulances, out-patient and in-patient care are the main services. The program covers 3 sub-counties. The premium varies depending on the number of people in a household.

Monthly Premium

Number in Household	Premium (Ush[10].) per month
4 or less	2,000
5-8	2,500
9-12	3000
More than 12	3000 + 600 for every additional person

A co-payment of Ush. 1,000 for outpatient and Ush. 2,500 for inpatients is made for each visit. The scheme covers all conditions with the exclusion of eyeglasses, cosmetic dental care, motor ambulance service, self-inflicted conditions, referrals , and funeral transportation.

Preliminary Ideas For Innovation!

This section focuses on demand-driven financial product innovations to address the need to prepare for the varied risk factors discussed in the previous sections. Most of the ideas borrow extensively from the informal sector that tends to be the greatest competitor for the micro-client. Therefore, it is extremely important that formal and semi-formal financial institutions have a thorough understanding of the informal sector in order to draw important lessons and to successfully develop demand driven products with appropriate systems of delivery The formal sector may adopt features of the informal sector, or may create or strengthen linkages the local knowledge of the informal agents and the greater financial resources of the formal sector to the mutual benefit of both (Jones, 1998).

Over the last three months, researchers from various East African institutions in partnership with the ***MicroSave*** *Initiative*, using a number of PRA, Focus Group Discussions and individual in-depth research techniques, interviewed thousands of poor people in both rural and urban areas. They sought to understand the poor people's financial needs and problems, the current coping mechanisms, the constraints associated with the coping mechanisms, the issues of importance in a financial device, and finally, identify the innovative institutional opportunities to respond to the needs of the existing and potential clients.

The following innovations and opportunities are still under review and include new products, product re-packaging, promotion strategies and adjusted service delivery mechanisms. The following are brief preliminary descriptions of the innovations that will ultimately undergo further scrutiny, testing, refinement, and pilot testing before they can be commercialised.

Financial Product Proposals

<u>Financial Products to Address Life-cycle Risks</u>

Regular small savings are important for financing life-cycle events because such events generally require substantial sums of money, and are often enough predictable. Therefore serious consideration should be given to savings product developed and marketed to address these risk factors specifically. The products should allow for small periodic contributions over an extended period of time in order to build a sizeable amount of money.

[9] Mid 1999
[10] Exchange rate USh1450= US$1

Below is a discussion of some of the potential ideas that have come to mind during the various research exercises in East Africa. Unlike the traditional products that are not descriptive of the motive, the ideas below bear names that reflect and emphasise the primary risk they are designed to address. The preliminary product ideas are based on the most frequently cited and most highly ranked risk factors. Of course, it would be unwise for an institution to introduce these products all at once. So the best strategy is to identify a few that can address the largest percentage of the aggregate problems to reduce the management risks associated with introducing multiple new products.

Potential products include the education cumulative savings product, the education fixed deposit savings product, housing savings product, wedding savings account, and funeral expenses savings account. Except for the education fixed deposit account, all the product ideas try to mirror some of the strengths in the most popular informal saving mechanism – the RoSCA while using the institutional strength of MFI to extend the duration of the disciplined saving, thus building up larger lump sums.

- <u>University and Post Secondary Education Saving Product</u>

This is a contractual savings product that would respond to one of the most frequently mentioned life-cycle risk factors, namely education fees. This need has even become more critical since all three East African governments terminated free university education. This product would require the account holders to commit themselves to contribute an amount periodically for an agreed period of time. This could be weekly, or bi-monthly or monthly.

This product would be most appropriate where the income stream is not significantly variable throughout the year. In the course of the research, it was found that many people would like to give their children a university education. It is clear that the earlier one starts working on this the more likely to achieve the objective.

The Mind is a Terrible Thing to Waste

"With a weekly contribution of Ush. 10,000 for the next five years, I can pay for my daughter's university education. You know, the brain is a terrible thing to waste," says Mary a market woman. Mary is excited about this product that was discussed by MFI market researchers who visited her group. She knows that her daughter who is now in the first year of secondary school, who wants to study commerce, will need Ush. 3,000,000 for the three year program. The MFI said they are considering introducing a savings product that would allow clients to deposit Ush. 10,000 per week for the next five (5) years with 8% annual interest rates. The account will also allow Mary to take short term emergency loans secured by the accumulating deposits.

- <u>University Education Bond</u>

This is a lump sum investment of modest amounts, which would be held for two to fifteen years in order to obtain the maximum benefit. There could be an option to make earlier withdraws with a penalty. The maturity of the bond would be designed to coincide with the number of years left before the child gets to university or post secondary school.

University Education Opportunity Bond

"What Norah needs to get a University education are 150 bonds bought this year since she has successfully passed her primary seven examinations" explains the lady from the bank to a group of parents. "Each bond, which now costs Tsh. 6,200, will give her Tsh. 10,000 6 years from now when she is ready to go to University. You can encourage the relatives and friends to buy her University Bond as a congratulatory gift instead the usual dresses and platform shoes. These bonds can be bought for up 2 to 6 year terms so that one can keep accumulating them for all the years they are going through secondary school. The important thing is that they are in small denominations and so a lot of people can buy them". The proposed bonds yield 8% per annum, compounded monthly.

- Education Fixed Deposit Savings Product

This is a fixed deposit contractual savings product suggested by people in areas where there are significant income variations during different parts of the year. Seasonal income variation is typical of most rural communities and businesses driven by seasonal income flows. In one area the respondents said most of their income comes during three months (September, October and November). Since they have a lot of money at this time, this is when they would like to have a fixed deposit for school fees for the lean month of July.

Fixing the School Fees Problem

"An education fixed deposit would be a very good service for the majority of us who have difficulty in keeping up with the second term school fees which fall within a low income month July," explained a participant in a focus group discussion in the Mashaati, Kirimanjaro area. "You see, during the months of August through to December, there is a lot of money in the community. It is the end of the harvest season and people are selling maize, beans, coffee and benefiting from the tourism peak season. Some people squander it while others resort to all kinds of ways of saving money for the second term, which falls within the low income season. An account that would lock money away would help many people in this area since we cannot keep money away from other competing demands some of which are not really very important. An account such as that will help us to keep our children in school." An education fixed deposit product is being considered for promotion by the local SACCO especially during the months of October, November and December. Since the average household has about four children going to school each household would need to deposit Tsh. 40,000 in the fixed deposit education account during the high income season to pay school fees averaging Tsh. 10,000 per pupil. The interest income, which accrues at 8%, can be used for buying some pencils and exercise books.

- Education Contractual Savings Product

Like all other education finance products, this would respond to the most frequently mentioned and highly ranked, financially burdensome life-cycle. Unlike the fixed deposit education product described above, this requires the account holder to deposit equal periodic amounts, as done in a ROSCA, for an agreed upon time that corresponds with the school term. In Tanzania for example, the contract term could be five months since they have two school terms in a year. On the other hand, Kenya and Uganda would find three month contract more appropriate since both countries have three school terms per year. This product may works well in a market segment that maintains a relatively stable income through out the year.

- Home Ownership Savings Product

This product is designed to assist people in acquiring a personal home. It is a contractual savings product that calls for small, periodic deposits over an extended period of time depending on the type of house in mind.

Most people buy and store materials over an extended period of time. This requires considerable storage space for materials –and can take an exorbitant length of time, usually five to ten years. The countless incomplete houses across East Africa represent massive amounts of unproductive capital laying idle and earning no interest for as many as ten years.

This product would also be good for people who are looking to take advantage of housing finance loans. For example, the Housing Finance Corporation of Uganda extends lower interest rate loans for acquisition of a home provided the client already has 40% of the money required to purchase the house.

Financial Building Blocks

"Building a decent low cost house for an average person in Mbale cost approximately 2 to 2.6 million, 0.6 million of which is for a plot," explained Baker Kasisa, a driver in Mbale, Uganda. "A lot of people, especially women in the market accumulate this money by participating in RoSCAs. After buying a piece of land, they buy bricks and sand that they deposit at the site. They buy iron sheets one at time if they can find a place to store them. It takes most people 5 to 8 years to complete the construction of a basic permanent house. A solid reputable bank enabling people to make small deposits over a long period of time would help a lot of people save money to own a modest house with less trouble. It would even be better if that bank could extend a housing loan if a client has accumulated a certain acceptable proportion of the cost of the house."

Based on the above, an average of Ush. 2.6 million, 6 year contractual savings account earning 6% interest per annum (compounded monthly) would call for a Ush. 30,000 monthly deposit. The bank/MFI could consider encouraging people to get into RoSCAs of four people each contributing Ush. 10,000 per week to an individual, who in turn would deposit money in the bank or MFI. The terms of the contract could range from six months to six years with automatic renewal options. This would assist people who are not willing to sign up for long term contracts due to reason ranging from seasonality of income to lack of confidence in the financial institution. a. To encourage longer term contracts, the interest rates should increase with the length of the contract. The bank or MFI may also consider attaching an emergency loan facility secured by the contractual savings account.

- Wedding Festivities Savings Products

This is another contractual savings account that would call for small periodic deposits over an extended period of time. In some parts of East Africa, wedding ceremonies are very expensive. While it is not unusual for relatives and friend to contribute one respondent explained that, "people now want to know that you have made some savings before they give you theirs".

- Funeral Expenses Savings Product

This product is designed as a contractual savings account that would require small periodic deposits until the clients are satisfied that they have sufficient resources to cover the risk. At present, the informal sector is the only segment of the financial community that has begun to respond to the need for funeral funds.

In Kenya there are countless *bursary clubs*. In Uganda there is a proliferation of self-help groups called *munno mukabi*. Both options are essentially informal funeral expenses insurance schemes (Wright et al, 1999). It appears that in most East African communities, a decent burial is extremely important and very expensive. People working in urban areas desire that their dead be buried in their ancestral homes upcountry. The funeral expenses tend to include the cost of a coffin, mortuary expenses, transport expenses, rental fees for chairs and the cost of food among other things. The need for a large lump sum of money to pay for a proper funeral has resulted in the proliferation of informal organisations specially designed to cover funeral expenses. [11]

- Old Age[12]/Retirement Savings Products

This savings product responds to another important life-cycle event. Since most people in East Africa are self-employed, this contractual savings product would offer greater security to the many working people who do not have an employer offering retirement benefits. Furthermore, an increasing number of employers no longer provide retirement benifits, and those that do, provide packages that barely cover food expenses, let alone housing and medication expenses.

[12] The product is labelled "old age" because in most people's minds, the word "retirement" implies that one is working for government or some big corporation and that it is that employer that plan it for you. "Old age" seems to carry personal responsibility

The product could be designed in such a way that one gets a lump sum at the end of the contract or one draws it down with time after maturity while the balance continues to earn interest. This product requires careful promotion because in some cases "retirement" is associated with those employed with government and big multinational companies. It is perceived as something an employer imposes on you and not something you do for yourself. For this reason, it is probably better to use the term *"old age"*, a more positively perceived description..

Old Age Income Account

"The difference between comfortable and struggling old people is how they planned for the time of their old age," says an MFI client in Katwe slums of Kampala. "If you build rental houses while you are still young and energetic you are likely to have a relatively comfortable old age. If you do not you will be miserable, striving, working, and perhaps even begging until you die. You will have no money for food and medical care. Under those circumstances you cannot live for long."

"On the other hand," he adds, "if you look carefully at rental housing investment, you might find that it is not as attractive as one might think. Rental properties are fraught with problems of defaulting tenants, perennial repairs, high rent taxes, and rapid physical deterioration." This and similar difficulties present opportunities for alternative competing old age security mechanisms. The researchers found that although the gross returns on rental property investments average 11% APR, they could easily be lost to the problems mentioned.

It is for this reason that some MFIs may consider experimenting with an "Old Age Income Account" as a alternative to rental housing investment. For example if a 30 year old man were interested in Ush. 140,000 monthly income during old age (55 years plus) for ten years, they will need to put away Ush 15,000 earning 7% (compounding monthly) for the next 25 years in order to build up a lump sum of approximately Ush 12 million. It should be noted that such a product may be too long-term for very poor clients, and would therefore require careful pilot-testing and marketing.

- Start-Up Capital Savings Products

This product is in response to one of the most often mentioned life-cycle needs - new business start-up costs. This product can be a contractual saving account with flexible contributions and restrictions on withdraws until a pre-determined period has passed. The flexibility of contributions is in response to the fact that students may not be in a position to make regular equal contributions since they tend to depend on the generosity of parents, relatives and friends.

All three East African countries are faced with a growth rate of employment opportunities that is far lower than the explosive population growth. One can therefore safely say that most graduates and school dropouts find it increasingly necessary to create their own jobs. Since most MFIs require that the borrower have an existing business that is at least a year old, potential borrowers must build up the initial capital to start a business before they can successfully access credit. And of course, if the MFI provides the savings service to set up the business, they are cultivating future loan business from a disciplined client who is already accustomed to making regular deposits.

- Group Savings Products

This product is in response to the often cited problem of paying to mobilise small savings. MFIs could consider promoting RoSCAs so that who ever gets the lump sum brings it to the bank (or in the event of more liberal legislation on savings deposits, to the MFI). This means that the bank would only have to deal with one person with a reasonably large amount of money at a time instead of the many depositors, each with small deposits. This would reduce the transaction costs for the bank because the bank meets only one person who has consolidated many small accounts.

This group savings product could be promoted among savings clubs that meet at religious institutions, immigrant urban communities, funeral clubs, clans and other such coherent groups that have reason to meet regularly. These groups can be helped to draft a constitution and establish a bookkeeping system for managing the group account.

Financial Products in Response to Crisis Risks

As discussed in the section on risk factors, crisis risks are sudden, unexpected shocks to the household that disrupt its ability to generate income. They tend to demand emergency interventions and therefore financial services products need to be designed to respond to such emergencies. Some of the most commonly sited crisis risk factors are sickness, fire, and theft.

- Healthcare Insurance/Savings Product

Although sickness is the most often mentioned crisis factor, it can be relatively predictable in communities where the seasonality of illness and the associated expenditure has an established pattern. However, when it comes to less predictable injuries like accidents, it can become a serious crisis risk. In several rural communities in East Africa, there are particular months in the year when certain illnesses, like malaria and pneumonia, sweep through the community. This degree of predictability makes it possible for individuals to plan for the illness. A savings product designed for that purpose might be what individuals want.

In one of the communities in Tanzania, the residents suggested that an emergency loan to cover health expenses would meet a critical need. The emergency loan, it was suggested, would be secured by the education fixed deposit product especially since the season with the high incidence of illness comes about two months before the beginning of the school term for which the education savings are held.

- General Emergency Loan Product

This product would respond to the most often mentioned crisis risks which include sudden unexpected shocks such a sickness, accidents, fire, and theft. It can be designed to be accessed by individuals who have savings. It would be of particular interest to those with a contractual savings product who would rather borrow than break a contract and lose the corresponding benefits or disrupt future plans. This loan should guaranteed by the savings account of no less than 100% of the loan face value and it should be disbursed rapidly, as is appropriate for emergencies.

Service Delivery Innovations

Taking the Service to the Poor and Accepting Small, Regular and Frequent Deposits

One of highest ranked attributes of viable savings/loan programmes commonly cited by the poor was the proximity of the financial service. The closer the service is to the client, the lower the transaction costs are. This is partly the reason why formal banks are not very popular with the poor and helps explain the popularity of the RoSCAs. Since RoSCAs meet at places of work, churches and homes, they are readily accessible. For this reason, MFIs should consider approaches for bringing the services closer to the poor. Ideas include introducing ATMs to using mobile tellers. Considering the technological challenges in the rural areas that house more than 80% of the population, the mobile tellers may be best alternative. They need not be graduates or highly trained people. They must have good interpersonal skills and be capable of reading, writing and simple arithmetic. This will reduce the cost of extending services. In one of the SACCOs[13] in Uganda it was observed that there was an impressive rate of growth of savings accounts when they introduced mobile vendors.

[13] Interview with the Chairman of Nakawa Market Vendors Credit and Savings Co-operative Ltd, Kampala, Uganda

Had It Not Been For The Mobile Teller!!!

"Membership more than doubled within less than a year after we had been in existence for over five years. Next year we believe we shall be 600 hundred members", recounts the chairman of Nakawa Market Vendors Association. "This is partly because we take the bank to the members. Secondly the discipline introduced by the two part time mobile tellers who walk through the market twice a day visiting members has made a big difference". A discussion with the Treasurer indicated that average members' balances also increased.

"Had it not been for the mobile teller," says a market woman who is a member, "most of us would not have saved as much as we have. Everyday you see them you start looking around for what to give him. Eventually you get used to putting a small amount of money everyday which we previously felt was too small to take to the co-operative office. It is these small amounts that have enabled me to own my stall."

One of the main worries about mobilising small frequent savings has been the cost to the MFIs. One possible way to reduce cost in addition to employing low cost mobile staff is organising client groups based on the most stable and popular social groupings. In Tanzania, one of the institutions is considering establishing clan based savings groups because in that area the clan is an extremely important and strong social unit. Once the groups have learnt the basic bookkeeping and banking procedures, the transaction cost for the bank will reduce significantly since they will deal with one individual representing an average of 30 to 40 people.

Conclusion

The risk environment and the demonstrated need for savings among poor present an infinite variety of potentially profitable and mutually beneficial possibilities for both the micro-clients and microfinance institutions. The key is to pay close to the micro-clients' needs, their current financial coping mechanisms, the constraints in the current coping mechanisms, the important issues for the clients and how all the organisation can provide services profitably.

The extensive use of special services offered almost exclusively by the informal sector is a strong indicator of the demand for new, more secure, formal or semi-formal savings products. However, it is important to note that these informal groups often serve more than a financial service. They often offer a social support network, which the MFI is unlikely to be able to replicate. This needs to be given adequate thought to gain an understanding of the potential of such a product.

East African banks and MFIs need go beyond the limited group-based micro-enterprise credit. They need to develop and pilot test new products and strengthen their product development capacity to produce microfinancial services that meet client needs and from which the MFI can levy charges that permit sustainability and profitability. In addition this will enable MFIs to increase the breadth and of their outreach. Those that do will be taking a risk: those that do not will be history (Hulme. D, 1999; Maximbali.F, 1999; Kashangaki.J, 1999; Mugwanga, A.H.A, 1999).

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