A roadmap to responsible linkage

Extract from: Connecting the World's Poorest People to the Global Economy – New models for linking informal savings groups to formal financial services

A roadmap to responsible linkage

CARE has seen the benefits that savings group members can gain through group access to formal financial services. We have also seen the scale of the potential market – hundreds of millions of people could gain access to financial services through a linked savings group model. This could not only make a huge difference to poor people's lives all over the world, but could spur new growth in the global economy by connecting the informal income-generating activity of millions with the formal financial system.

But despite this vast potential, it is critical that actors engaged in promoting financial linkage proceed with caution. Introducing savings group members, many of whom are illiterate, to banks and other financial institutions can expose some of the most vulnerable members of society to significant financial risk. As the cost of reaching individuals decreases through the use of mobile banking, it is even more important that the most vulnerable members of society are protected.

Perhaps the best consumer protection mechanism is the group format itself. Groups are less likely than individuals to be duped by unscrupulous moneylenders. Financial literacy training is more easily (and cost-effectively) provided to groups, and concepts are better understood when weaker members have a regular setting in which to interact with stronger members whom they trust.

CARE has distilled its experiences into a set of principles for linkage, described below. These formed the basis of the Linking For Change Savings Charter (but are more detailed and focus on groups). This not also describes how to assess the readiness of groups to be linked, and includes tips on partnership. CARE and others are currently developing a more detailed Linkage Handbook to enable uptake. This is due in 2015.

CARE's principles for linking savings groups to financial institutions

01 Link groups, not individuals
Groups should be linked to financial institutions rather than individuals. The purpose of the relationship is to complement the group's existing activities. The result should be a strengthening of group cohesion and should benefit all members. Individual linkages that rely on the group as a guarantee is not recommended for savings groups. If a group is not ready for linkage, but there are some individuals within the group seeking linkage, then they should proceed independent of their membership in the group.

02 Only link mature groups
No group should be linked before they complete at least one cycle and share-out. In some exceptional cases, it may be necessary to begin a savings linkage during the first cycle, but no exceptions should be permitted for credit linkage. All groups who have completed at least one complete cycle of savings and share-out and express a desire to link to a financial institution should be rated using the Linkage Readiness Assessment Tool (or similar). Groups that attain a satisfactory rating should be linked.

03 Focus on demand rather than supply
Linkage relationship should be based on the needs and demands of the groups rather than being thrust upon the groups. Because linkage creates additional liabilities for the group, it is important that the groups are ready for such liabilities. Groups should be provided with all information necessary to understand the products and services on offer.

04 Prepare groups before linking them
Groups must be provided with training prior to linkage. This should cover any basic financial literacy modules not already provided as part of the process of forming the group, as well as specific information about the proposed institution they will be linked with, the products the institution is offering, account opening requirements, and any other relevant information.

05 Protect core savings group principles
The linkage relationship should not alter the fundamental operating principles of the savings group methodology. The group should maintain its governance structures and procedures, record-keeping and internal controls, and regular meetings with a focus on savings. Linkage decisions should be made by consensus as far as possible rather than by majority.

06 Start with savings
VSLA is a savings-led approach and linkage should not alter this focus. Savings linkage should precede credit linkage, and access to credit should not undermine the overall group emphasis on savings.

07 Maintain a conservative savings to credit ratio
To prevent groups from becoming over-indebted, it is important that a conservative savings to credit ratio is maintained. Using the group's previous cycle share-out amount as a measure of savings (rather than the current savings amount, which is an unreliable indicator of the group's capacity), the amount of the group's first loan should be no greater than twice the previous year's share-out, ie a savings to credit ratio of 1:2. For subsequent loans, it can be increased, but should never exceed a ratio of 1:5.

08 Minimize the use of savings as collateral
The flexibility and accessibility of savings is considered an important attribute by group members. Thus, where possible, group savings should not be held as collateral by financial institutions. It is recognised that financial institutions seek to secure their loans, so this principle must be applied in a way that balances the priorities of the savings group and financial institution. The principle does not mean that no collateral should be provided to the financial institution, but that collateral should be kept to a minimum.

Recommended stages to develop linkage

1 Analysing the context

Needs analysis

The first step in exploring linkage is to assess the group's needs and demand for linkage to ensure appropriate products and services are offered. Focus group discussions with a sample of groups is generally the most appropriate method for such an assessment.[1]

Identify potential partners

In parallel, the broader financial sector context should be studied, mapping out which formal financial institutions target – or could potentially target - savings groups. Even if a bank does not have an extensive branch network, it may still be a potential linkage partner if it is interested in the low-income market and is willing to invest in mobile banking, for example.

Assess the regulatory environment

In most countries, regulations do not allow informal groups to become clients of formal banking institutions or mobile service providers without being formally registered and recognised as a legal entity. It may be necessary to work with national and local authorities and the partner FSPs to help groups to become registered.

2 Setting up an effective partnership

Plan how to work together

Develop a common vision between all partners outlining the objectives, the strategy for achieving them, and the key milestones. This includes defining roles and responsibilities for each partner, setting up joint working committees for specific tasks (such as product research and designing), and encouraging staff to work together on designing and delivering products and services.

Senior staff involvement

The FSP's senior management must be actively involved from the outset. Partnerships that are signed off at high level but include no major engagement from decision-makers in the design and implementation phases tend to struggle. Decisions at headquarters stand a better chance of being effectively carried out in branches if they are endorsed and promoted by senior management.

Acknowledge differences

It is important to acknowledge that partners' interests and motivations may be different. Frank and open discussions about mutual expectations will help to keep the focus on developing a sound partnership and appropriate products for savings groups. As discussed below

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1. Questions should probe perceived needs around both savings and credit, typical cashflow patterns for group members, how existing cashflow volatility is managed, perceptions of formal financial institutions and proximity of these institutions to the group, and whether members have existing savings accounts or external sources of credit.

(see section 6, page 9), the sustainability of the partnership will almost certainly depend on its long-term commercial viability, but this need not be the primary driver at the outset.

Develop a Memorandum of Understanding

A clear Memorandum of Understanding outlining the details of the agreement between the partners is essential. It should include success indicators, mitigating and managing risk, monitoring mechanisms and procedures for leaving the partnership.

Ensure clients are protected

It is important to follow the linkage principles to ensure savings groups' interests are protected and that they are not introduced to loan products too quickly. CARE was closely involved in the pilots – during demand assessment, product customization, delivery channel design, group training and in ensuring quality of service delivery.

3 Designing the product and delivery channel

Product design

Products and processes need to be designed collaboratively to ensure they provide groups with what they need, and that they don't undermine or replace the existing cohesion and ownership of the group. This does present challenges. FSPs are usually the partner with the most technical know-how, but they don't always understand how savings groups work; groups are not usually familiar with FSP's requirements. There is a significant risk that groups will borrow too much. Products and processes should complement the way groups already save and work together.

Delivery channels

Access and transaction costs are the most important factors in choosing delivery channels. Proximity to the branches, use – or not - of mobile banking and transaction costs will determine who among the savings groups will be included or excluded from the linkage scheme. The collaboration with a linkage partner should be assessed in terms of the distribution channels that can be offered.

4 Preparing the groups and the financial service provider for linkage

Before committing to linkage, it is essential that groups and the formal financial institution staff are well prepared.

Assess savings group preparedness for linkage

The VSLA Linkage Readiness Assessment Tool (or similar) should be used to determine which groups are sufficiently mature for linkage. The tool works as a scorecard that assesses nine quantitative elements (ranging from savings information to the value of the funds that have been loaned). Six qualitative factors capture group characteristics such as member discipline, meeting procedures and quality of record keeping. On the basis of the total score obtained by a group (75% from quantitative factors and 25% from qualitative elements), CARE recommends to the group and the financial institution whether or not the linkage should take place.

Preparing groups for linkage

CARE recommends a structured training programme[2] delivered to savings groups as part of their routine weekly meetings. It should tackle misperceptions about financial services and provide grounding in financial literacy.

Awareness building for bank staff

An awareness workshop with partner bank staff (both management and front-line staff) will help them to understand the savings group methodology, linkage product delivery and linkage principles.[3]

The pilot

Once the product prototype and the delivery channel have been developed and groups and FSP staff have been trained, the pilot can be rolled out with a small sample of existing mature groups. The purpose of the pilot is to determine whether it will be sustainable at scale and to adjust product features and delivery accordingly.

2. CARE's own programme contains the following five modules: Overview - what is linkage and why linkage; Understanding the linkage product; Formulating groups' internal norms for participating in linkage; Managing VSLA records for linkage and Understanding the impact of external linkage on members and VSLA These modules will soon be publicly available on CARE's website.

3. This awareness workshop with partner bank staff includes five modules: functioning of a VSLA, key principles in VSLA functioning, record keeping system in a VSLA, linkage product to be offered to the VSLA and assessing a VSLA.

Linkage Readiness Assessment Tool

No.	Criteria	Measure or Variable	Scoring Criteria	Score
		QUANTITATIVE MEASURE – TOTAL MARKS 75%		
1	Maturity of group	Date of first savings cycle	**Measure** < 1 year 1-2 years > 2 years	**Score** 0 6 10
2	Savings volume on previous cycle (in U.S. dollars)		< $678 $678 – $1,017 $1,017 - $1,695 > $1,695	0 7 10 12
3	Savings volume of this cycle (in U.S. dollars)	Net value of savings at this cycle	< $254 $254 - $339 > $339	0 3 5
4	Attendance rates	Number of members attending meetings	< 80% 80% - 90% > 90%	0 3 5
5	Loan fund utilization	Value of loans outstanding / Total assets of the group (i.e., value of fixed assets and other funds)	< 50% 50% - 75% > 75%	0 6 10
6	Portfolio at risk	Portfolio at risk	PAR > 10% PAR > 5% & < 10% PAR > 3% & < 5% PAR > 1% & < 3% PAR = 0%	0 3 5 8 10
7	Amount written off as a % of last share-out amount	Amount written off at share-out	5% or more 2% - 5% 1% - 2% 0%	0 3 6 10
8	% of members with active loans	% of members with active loans	< 40% 40% - 60% 60% - 80% > 80%	0 3 6 8
9	Value of investment (in U.S. dollars)	Amount of money that has been used; average loan per member	< $8.47 $16.95 – $33.90 $33.90 – $50.85 > 50.85	0 3 4 5

No.	Criteria	Measure or Variable	Scoring Criteria	Score
		QUALITATIVE MEASURE - TOTAL MARKS 25%		
1	Member discipline during the meeting	Did all the members come on time for the meeting, or, if some members came late, did they pay a fine?	**Yes**	4
			No	0
2	Meeting procedures	Were all the members seated according to their number and did they carry out transactions in that order?	Fully as per procedure	4
			Generally as per procedure	2
			Significant deviation from procedures	0
3	Member awareness of group norms	Did all members appear to have good awareness of group norms?	All members display awareness	4
			Most members display awareness	2
			Very few or none display awareness	0
4	Decision-making about loans	When a member wanted to take a loan, did the secretary check how much they had saved in this cycle and apply the rule of providing a loan not more than 3 times the member's savings in this cycle? Were all decisions made with consensus?	Yes	1
			No	0
5	Quality of record keeping	Errors in transactions recording	Loan recording Principal Yes=0; No=1	1
			Interest Yes=0; No=1	1
			Savings and date of saving recording Yes=0; No=1	1
			Closing balances Yes=0; No=1	1
6	Members' discipline during the meeting	Discipline and participation in decision-making, group transactions	No discipline or participation Good discipline and participation	0 3

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The scoring categories and point allocation system applied are as follows:

Scoring Categories and Point-Allocation System

No.	VSLA Marks Obtained	Decision about Linkage
1	Less than 40 marks	The group should not be linked.
2	40 – 59 marks	Link the VSLA ONLY for savings products.
3	60 – 79 marks	Link the group for both savings and credit, but credit not to exceed 50% of the amount shared out in last cycle.
4	80 marks or above	Link the group for both savings and credit, but credit not to exceed 2 times the amount shared out in last cycle.

5 Monitoring the linkage process

Because linkage between savings group and formal financial institutions is still at a pilot stage, monitoring progress is critical to identify dysfunctional aspects and to make regular adjustments on delivery channels or products. CARE, its implementing partner organization and the linkage partner must jointly agree on a comprehensive monitoring and evaluation plan including a set of indicators that can be tracked through the regular management information system.[4]

Objectives should be formally reviewed every quarter using the Linkage Readiness Assessment Tool to determine what adjustments need to be made to improve the development and integration of the linkage process into the financial institution business stream. While CARE and its implementing partner organization have a role in facilitating the linkage, especially in the initial phases of a pilot, it is equally important for the FSPs to 'own' the business relationship with the linked groups, for it to be sustainable beyond the project.

4. Useful questions include: 1)At client level: Who are the clients who are using the linkage product? Do they understand the key features of the linkage products? How are they using the different linkage products? What is the impact of linkage arrangement on the routine functioning of the group? How are the clients finding the delivery channels designed for delivery of linkage products? 2)At implementing partner organisation level: Is linkage an arrangement helping in faster and automatic replication of VSLA methodology? How does linkage impact the cost per client? Are there clients who are suffering negative consequences due to linkage? 3)Financial service provider level: What does the linkage partner financial institution think about linkage? Has it helped the financial institution in penetrating a new market segment? Has the front line staff developed adequate understanding of the VSLA methodology? What is the value that the senior management of the financial institution perceives in the linkage arrangement? What are the ideas from the financial institution's senior management and front line staff about scaling up the linkage programme or to bring down the operational costs? Source: Practitioner's Guide to Facilitate Linkage between VSLA and Formal Financial Institutions, CARE Access Africa 2009.

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6 Working toward long-term commercial viability

Long-term business viability

The most important criterion for partnership is the FSP's commitment to savings groups as a viable market segment, on a long-term basis. CARE, on reflection, feels that it is not critical for partners to design 'perfect' products for the groups from the beginning. It is more important that there is evidence that FSPs are interested in savings groups as a viable business opportunity, are willing to understand their demand, invest their own resources for designing and offering products, and thus demonstrate their commitment in concrete ways. The long-term motivation for the FSPs will depend upon the business viability of their group products. Eventually, for the linkage partnership to survive in the long run, the relationship must be mutually beneficial.

There seems to be some tension between the FSP interest in scale and profitability and CARE's interest in the group's readiness, capacity building and more cautious approach to loan products. Balancing of interests and trade-offs will need careful management.

FSPs that have included mobile technology as a means for reaching remote clients are the ones that are most likely to achieve scale. The FSPs that are open and have strategically developed a space for mobile technology have been the forerunners in loan product development and linkages on the ground. Banks like MCB and Equity Bank have included in their strategies two major mobile network operators in the region. Initiatives that have gained the most savings group clients have the greatest chance of reaching across borders, being scaled up and adapted to the varying contexts in which savings groups and their members operate.

Business case

For each linkage pilot, all parties must understand the critical mass of clients and groups that is needed for the business model to work. The viability equation will be different for microinsurance products than for savings or loan products. There are some concerns that a focus on commercial viability may compromise the ability to reach deeply into remote areas to the poorest people. Sound data and regular monitoring are necessary to determine whether this is the case.

About CARE International

CARE International is one of the world's leading aid agencies. Last year, we worked in 84 countries, supporting 1,015 poverty-fighting projects that reached 122 million people. For more information about CARE, visit: www.careinternational.org.uk

About the Coady International Institute

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New CARE Financial Linkage Handbook – available 2015

CARE is working through SEEP and convening other facilitating agencies to develop a Financial Linkage Handbook that will serve as a guide and toolkit to Savings Group implementers, Financial Institutions and Mobile Network Operators wishing to create products for savings groups. The Handbook will be published in late 2015. To find out how you or your organisation can contribute to the development of the handbook, please contact the SEEP Network.