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It Is Expensive to Be Poor:
Losses Suffered by People Saving in Uganda

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MicroSave

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1.0 INTRODUCTION

1.1 *MicroSave* and Its Research Into Savings

MicroSave's study programme has largely focused on the perceptions and reality of poor people, the clients of MicroFinance Institutions (MFIs). Throughout the first two years of this work, the qualitative research techniques used by the ***MicroSave*** staff and consultants highlighted:

- the remarkable need, determination and commitment of poor people to save; and
- the alarming rate and level of loss of savings by poor people as they sought to save.

In response to this, ***MicroSave*** intensified its research concerning how and why poor people save (see Wright et al., 1999; Mutesasira, 1999a; Rutherford, 1999; Wright, 2000; Kalala and Ouédraogo, 2001), and the rate and nature of losses they suffered in the process. In the context of the latter issue, ***MicroSave*** also hired a private sector market research company, Research International, to conduct a survey to quantify the rate and level of loss amongst poor people saving in the formal, semi-formal and informal sectors (see Wright and Mutesasira, 2001).

This paper complements the largely quantitative study by Wright and Mutesasira (2001) because it provides additional qualitative data and the insights derived from it. Both papers address the strong and often passionate suggestion by some regulators that they should close user-owned and managed MFIs on the basis that:

1) they pose a great threat to poor people's deposits and
2) the central bank does not have the capacity to supervise them.

For this reason, the argument goes, in the interest of securely maintaining savers' deposits, it is the moral obligation of the central bank to keep user-owned and managed MFIs closed until such a time when the central bank has sufficient resources to fulfil the supervisory function.

1.2 Methods

This research sought to explore the options left to clients in the absence of user-owned and managed MFIs, and the clients' perceptions and attitudes towards this possibility. Using Focus Group Discussions, Participatory Rapid Appraisal techniques and individual in-depth interviews in the Central and Western parts of Uganda[2], information was sought from over 150 individuals in urban, peri-urban and rural areas. The research explored the entire financial landscape ranging from the informal, semi-formal to formal institutions, and asked users to rank the relative risk of various financial devices.

The findings of this primary research were supplemented by existing extensive qualitative data comprised of over 500 focus group discussions (with groups averaging 6-8 people) and another 200 plus individual in-depth interviews. Additional secondary data came from the quantitative study conducted by Research International[3] that covered the Eastern, Central and Western parts of Uganda, and surveyed 1,500 low income respondents who use a wide variety of financial devices to save.

[1] The authors would like to thank Roland Pearson, Marguerite Robinson and Hugh Scott who kindly reviewed this paper and gave very helpful comments – errors and omissions remain those of the authors and are jealously guarded as such.

[2] Research was conducted by *MicroSave* in Masaka, Mukono, Mbarara Districts over a one month period.

[3] Under contract to ***MicroSave***

1.3 Summary of the Issues

The findings indicate that community-based MFIs, though undeniably risky, are ***relatively*** less risky than the informal sector options remaining to the poor in the absence of these institutions. If restrictive regulations (often driven by the limitations of the supervisory capacity of the central bank) are applied to the operations of community-based -MFIs, the poor will be forced into a considerably more vulnerable position.

Supporters of central bank-driven regulation and supervision often seek to prohibit MFIs from offering savings services on the basis that either MFIs represent a risk to poor people's deposits and/or the central bank does not have the capacity to supervise the MFIs. However, this prohibition is likely to have some unexpected and undesirable results.

In the words of Christen and Rosenberg (2000), "Kate McKee of USAID has pointed out that such a policy is often tantamount to telling people in those communities that if high-quality (i.e. effectively supervised) deposit services can't be delivered to them, then they should have no deposit services at all. Especially in rural areas, 'unsupervisable' deposit takers may be the only ones willing and able to operate in a given locality. Clients are often well aware that such organisations are risky, but continue to use them because the other available savings options are even riskier." Therefore, Wright and Mutesasira (2001) concluded, "When considering 'safeguarding the deposits of the poor', it is essential to think in terms of *relative risk* rather than *absolute risk*. In the same way that rich people make investment and savings decisions on the basis of the relative risk and return of the variety of opportunities available to them, so poor people are constantly faced with the need to assess the relative risk of the limited options they have to save".

MicroSave's research indicates that the informal sector mechanisms do indeed carry a far higher level of risk than the alternatives offered in the semi-formal sector (i.e. MFIs and SACCOs). Results from a recent quantitative study (Wright and Mutesasira, 2001) indicate that in 1999, respondents had saved an average of Ush.211,000 (US$132) in the informal sector, and 22% of that money was lost. The same study indicated that 82% saved in-kind and of these 75% lost some of these savings due to theft (in 33% of cases) and animals falling ill and dying (in 48% of cases). In addition, 68% of the sample reported saving at home and losing a large amount of their savings 50% of which was due to demands of friends/family and theft.

The results clearly demand a greater examination of the poor people's risk environment before declaring well intentioned policies that may hurt more than protect the interests of the poor. The findings also challenge the entire financial sector to look for creative ways of extending secure, high quality savings services to the poor using devices that may not be within the supervisory reach of the central bank.

1.4 The Financial Landscape

The financial landscape has been subdivided into three broad categories, the informal, the semi-formal and the formal (Rutherford, 1999). The three sectors are inter-linked to varying degrees in different locations in Uganda. Throughout the research, respondents emphasised that as a good practice they diversified their portfolio into a range of financial devices in order to address the needs for liquidity, illiquidity, access, returns and risk management. However, in most parts of the country, the poor conduct financial transactions mainly within the informal sector, which has only occasional linkages to the formal or semi-formal sectors.

The ***informal financial sector*** claims the greatest proportion of the savings portfolio of the poor. This sector serves over 60% of the population. It tends to be the only option for people living in rural areas although it has a very strong presence in the urban areas where many users also have formal bank accounts. One of the major reasons for the resilience of the informal sector is its response to the weaknesses of the formal sector (FAO, 1995). This sector operates outside of central bank or government supervision and providers may not be legal entities. There is an upsurge of these types of institutions across Uganda and indeed other parts of the world (see for example Ardener, 1995, Aryeety, 1991, Bouman, 1995 and Kalala and Ouedraogo, 2000). The informal sector includes saving at home, RoSCAs (Rotating Savings and Credit Associations), savings clubs, ASCAs (Accumulating Savings and Cooperative Associations), mobile deposit collectors, moneyguards and savings-in-kind, reciprocal lending, informal insurance schemes and supplier credit (Rutherford, 1999).

The ***semi-formal sector*** mechanisms are not licensed and supervised by the central bank but usually by other authorities like the registrar of co-operatives or some other governmental agency. The most common examples are NGO-MicroFinance Institutions, Savings and Credit Co-operatives (SACCOs)/Financial Service Associations (FSAs) and "village banks" which are often community-based financial organisations owned and operated by the users. NGO-MFIs often require compulsory savings (effectively loan insurance funds) as part of their lending arrangements. The SACCOs, FSAs and "village banks" are usually designed to mobilise savings by offering an opportunity for people to keep deposits that are then intermediated for purposes of productive, protective and consumptive purposes.

The ***formal sector*** includes banks and non-bank financial institutions that operate under the central bank's supervision. The formal sector tends to be unresponsive to poor clients needs, too removed from the reality of the mass market, too bureaucratic, and too rigid to respond to the credit and savings needs of the poor. This makes the formal sector largely irrelevant to the poor.

This paper does not focus on detailed description and functioning of these various financial mechanisms because several detailed studies have been prepared on the financial landscape in Uganda (see Rutherford, 1999 and Mutesasira, 1999b for example). It focuses rather on their comparative risk and describes functional issues only as they influence the relative safety of the users' money and offers a range of suggestions drawn from discussions with clients and microfinance practitioners.

2.0 SAVINGS AT RISK

2.1 The Informal Sector

2.1.1 Savings In-Kind

Table 1. Savings In-Kind

	Number of clients who saved this way in past 12 months	% of those using each service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year –Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
TOTAL	1,232	82%	75%	434 ($271)	92 ($57)	21%

Source: Wright and Mutesasira, 2001

Savings in-kind is the most popular savings mechanism among poor people. In 1999 82% of the respondents saved in-kind an average equivalent of $271. Of these, 75% lost an average of $57, which was 21% of the average amount saved in the last 12 months. These are huge losses for a country whose income per capita is approximately $300.

Box 1. Loss at the Grain Bank

"Like many others, I harvest a large maize crop which I stored awaiting payment for school fees. Besides the prices were too low so waiting was a reasonable thing. When the prices went up, I pulled my bags out only to find that many of the bags had been attacked by weevils. I lost close to a third of my harvest."

"I bought beans at Ush. 200 a kilo during the harvest period. Unfortunately there was a bumper harvest of beans in Bulegeni sub county during that season, so I was forced to keep the beans for four months before I sold them again … at Ush. 200 per kilo. This was at a loss to me because the beans had dried out and so there were fewer kilos to sell by then, and I had put in a lot of effort to preserve the beans over those four months."

Typical savings in-kind include animals (cows, goats, pigs, chickens etc.), in grain (maize, rice etc.), in other commodities (beans, coffee etc.) and in construction materials (bricks, wood, corrugated iron etc.). 48% of those who had lost said that it was due to illness of the animal, 33% had lost due to drop in value of saved item due to price fluctuations. 33% lost due to theft of the saved item. Other relatively less significant reasons include bad weather, damage during transportation, poor storage facilities, non paying creditors, death of the animal and decrease in demand for the item.

2.1.2 Saving at Home

Table 2. Saving at Home

	Number of clients who saved this way in past 12 months	% of those using each service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year – Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
TOTAL	1,025	68%	68%	146 ($91)	38 ($24)	26%

Source: Wright and Mutesasira, 2001

Sixty eight percent of the respondents indicated that they save at home making it the most prevalent savings device after saving in-kind[4]. Sixty-eight percent of those who save at home lost some of that money in the year 1999. Savings at home takes many forms including a *mukandala*[5], under the mattress, in a *kittavvu*[6], and a *muzaaya*[7], which are the terms used in some areas for moneybox. The money box has become increasingly popular in many rural and urban communities, mainly due to the closure of several rural banks, the increase in minimum account opening balances and the general lack of confidence in the financial sector in the aftermath of the 1998/9 financial sector crisis in Uganda.

There is a clear gender bias concerning the perceived risk of saving at home. Most men feel saving at home is very unsafe while most women believe it is the safest place to keep money considering the available accessible alternatives.

Those who felt saving at home was unsafe believed that a thief or member of the household could easily steal all the money. It is important to note that most people who held this view were from families that live in crowded conditions. Respondents argued that crowded homes with little privacy were more risky that those where the respondents had private rooms they could lock. Since most of the poor rarely have private, secured rooms, they concluded that their money was at risk in the home.

Box 2. A Sad Song

"In order keep money, sometimes you can dig a hole in the garden, in the roof rafter, under the mattress or such places, but you need to be sure no one has seen you or else you will have a sad song to sing next time you go to check. Unlike the rich most poor people rarely have private rooms they can lock up and so they keep losing their savings to their unemployed teenagers and drunken husbands who occasionally steal or forcefully use other people's money." – Mama Simolo

There are those who felt that savings at home are much safer than ASCAs, RoSCAs and even banks because they have minimal external management. "Since one individually determines the amount to save," explained Goretti, a participant in one of our focus group discussions, "one avoids the pressure of periodic payment as in ASCAs and RoSCAs, which often result in group disintegration. You can secretly maintain your records from potential thieves and rumour mongers." This sentiment was echoed by more people who felt that

[4] It is reasonable to suggest that this may be an underestimation of the proportion of people saving at home since 1) this is often a sensitive issue to discuss in focus groups as it can be viewed as a security risk or bragging and 2) small amounts kept in the home in readiness to respond to emergencies are often not seen as "savings".

[5] This is a Luganda word meaning money belt one ties around their body as part of their undergarments for safe keeping of money. It is mainly used by women.

[6] A clay pot used in the past to store coins – the clay pot is half filled with ashes to preserve the notes and coins from being eaten by bugs. Hence the name *kittavvu* whose literal translation is "that which kills ashes"

[7] This is a term used by some women in parts of Masaka district. The literal translation is "that which sends things from sight". These boxes are usually made by carpenters with a hole for slotting in the money. Access to this money is almost impossible (hence the name *muzaaya)* you must either break the box or take it to the carpenter for opening.

savings at home are free from endless, stressful penalties, and long cycles experienced in some RoSCAs and savings clubs, risk of default typical of ASCAs and the tensions caused by poor record keeping which is characteristic of ASCAs.

"The piggy banks are safest because the owner is the manager, the supervisor and regulator," said one male respondent who echoed the feeling of many. Women especially felt it was the safest place for savings because they were absolutely in control.

2.1.3 RoSCAs (Rotating Savings and Credit Associations)

Table 3. RoSCAs

	Number of clients who saved this way in past 12 months	% of those using each service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year – Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
TOTAL	349	23%	27%	139 ($87)	9 ($6)	6%

Source: Wright and Mutesasira, 2001

RoSCAs are by far the most popular collectively organised[8] informal financial device in Uganda. Wright and Mutesasira, 2001 note that 23% of the lower income population participates in RoSCAs and that 27% of those participating lost 6% of the money they had saved in RoSCAs during the last year. Unlike some RoSCAs in Asia, which may have independent outside managers, users almost invariably manage their own in Uganda. Like ASCAs they tend to be more vulnerable to failure if membership is not homogeneous according to income levels, occupation, gender and sometimes religious beliefs.

Box 3. Religion Binds Us Together

"Because we belong to the same place of worship and share similar religious values," explains Mary, "we are less vulnerable to losses due to default. Our common religion binds us together. If people come together for just economic reasons, as is common in urban areas, they are likely to suffer more default and eventual loss of savings."

There are increasing reports of RoSCA members losing money especially in Western Uganda where they disintegrate because of drought, which has negatively affected the cash flow of many households and caused members (particularly those in cash crop dependent area) to default (Wright and Mutesasira 2001). These unintended losses are considered to be "understandable and easily forgivable" by the members. Large RoSCAs of 30 members and above tend to break-up because of management problems causing losses to some members. It is for this reason that smaller size RoSCAs are more popular because they have experienced fewer management problems.

Because of the cyclical nature of income in most areas, the regularity and size of contribution to RoSCAs/ASCAs is often a problem, and can cause loss since members are unable to make the required contributions. As a result, experienced and successful RoSCAs have generally opted for shorter cycles, with fewer people, where contributions can be adjusted according to the local seasonality of income and expenditure. As with ASCAs, excessive fines and penalties for failure to make weekly contributions have induced discipline but have sometimes triggered default if applied in excess.

The choice of who shall receive the prize was frequently reported as a cause of loss to members. There are several ways of awarding the "prize" (pay-out), including lottery, chairperson's judgment or longevity of membership. The lottery has not been successful and has caused losses because when new members are given the prize first they tend to default on future contributions. Many RoSCAs have therefore learnt the hard

[8] The most popular form of non-collective unorganised savings is "saving-in-kind", closely followed by cash savings at home and reciprocal lending

way that the best way to allocate the prize is in order of membership seniority unless the RoSCA is composed of members that have a long affiliation with each other.

Losses have been common amongst groups that choose who will receive the prize based on urgency of personal need. This has left some of those asked to wait to receive the prize unhappy and has induced a feeling of indifference to the group because of the perceived "favouritism" and has often resulted in default by dissatisfied members.

2.1.4 ASCAs (Accumulating Savings and Credit Associations)

Table 4. ASCAs (Accumulating Savings and Credit Associations)

	Number of clients who saved this way in past 12 months	% of those using each service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year – Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
TOTAL	107	7%	40%	135 ($84)	28 ($18)	21%

Source: Wright and Mutesasira, 2001

An ASCA[9] is composed of people who periodically get together to pool money from which a few take loans with interest. At the end of the cycle everybody gets back their contribution and a share of the interest income based on their contribution.

ASCAs were ranked as the most risky financial devices in Uganda's recent financial history. The most widely known ASCA, was popularly known as BURIAL[10]. BURIAL was a franchise type of ASCA that swept across different parts of Uganda leaving massive losses for participants in its wake. The concept was originally designed by people in Iganga District with the aim of "burying" poverty, improving domestic health, nutrition, etc. The scheme spread rapidly during the late 1980's in the East and up until the late 1990s in the West of the country.

Box. 4. The Infamous BURIAL Clubs

"Countless techniques were used to get us into the BURIAL club," explains a former member of the BURIAL. "These included promises of big prizes like plates, mattresses and other household items. The initial members received these prizes, and this drew many people to join. Several months down the road, the rules of the game changed, the "teachers" became unscrupulous, connived, fixed the lottery tickets and eventually took all the money. Thus, fulfilling the hidden meaning in the word BURIAL. A large number of people lost their life savings in this scheme. One of them is a man in this community who lost over Ush.500,000 ($277.77). He has never recovered from the shock."

Many poor people have lost money in ASCAs because they tend to require relatively complex record keeping and computation skills which are normally in short supply among the poor and illiterate. This often causes suspicion, confusion, disagreements and eventual break up of the scheme. Because ASCAs collect savings which are lent out, this introduces the need for recording:

- savings contributions,
- the number of shares each participant has,
- the interest income,
- loans made,
- repayments collected,
- income from fines and penalties for late payment and non-attendance, and finally
- the computation of dividends, etc.

[9] ASCAs have many variants, which are described in detail in Rutherford, 1999 and Mutesasira, 1999b.

[10] A more detailed account can be found in Mutesasira, 1999b.

However, as complex as the ASCA record keeping can be, understanding the magnitude of losses is also complex. It is important to note that in some cases what users have reported as "losses" are in fact not the loss of deposits but the non-fulfilment of expected returns.

High interest rates (typically 10-20% per month), fines and penalties tend to increase debt obligation and subsequently trigger default especially during economic downturns. As one respondent argued, and many concurred, "The recent massive loss of savings by ASCAs is not a result of pre-meditated default but rather a reflection of the hard times triggered by the protracted drought in this part of the country. The problem is made worse by the fines and penalties imposed for late payments, which (when not paid immediately) compound daily interest at an astronomical rate. In the long run the debt is so overwhelming the borrower is forced to default sometimes without paying the principle."

Group dynamics and local influence can greatly increase an ASCAs chances of success or failure. ASCAs have often had more difficulties when clients were forced to sell collateral in order to honour a lending contract, and groups were heterogeneous in terms of age, sex and economic activity. Homogeneity helps to maintain group cohesion. ASCAs that are registered as self-help associations[11] with one of the village authorities, as is the practice of some, are reported to record fewer losses of deposits. In parts of the country where they are not registered in this way, respondents believe that registration would help reduce the risk because the registering body (village council in most cases) would have a basis for intervening in settling disputes which may include the enforcement of sale of pledged collateral. In areas where they are registered, this has been cited as crucial, with important cases settled at the "village level court". The shortcoming of the registration process is the short life of these ASCAs and the corresponding corruption of some local government operatives who seek a bribe in every dispute that comes their way. In some cases, especially in urban areas, it is reported that justice favours the highest bidder.

Box 5. I Lost the Interest – Others Lost Principle Plus Interest

In several instances, it became evident that losses in ASCA were not losses of principle but losses of interest receivable. "We were 20 people and each had varying number of shares," explained a lady in Ibanda, "I had 6 shares each bought at Ush.3,000 ($1.67). Therefore at each weekly meeting I had to contribute Ush.18,000 (3,000 x 6). This went on for 6 months. I was able to get my capital contribution of Ush. 110,000 but was unable to get the dividends. I do not think I will get the dividends. Groups have failed and everybody is crying. There some those among us did not get the capital investment back. They lost. They each lost about Ush.220,000 ($122.22)".

In many areas, users and non-users alike believed that ASCAs have resulted in losses because they are run by unsupervised individuals without professional training. Many respondents reported that ASCAs introduced and promoted by local people known in the community have stood a better chance of survival than those promoted by people from outside communities. This is because local promoters often have their reputation to protect while outsiders simply "shift residence during the night." This was the case in many places with the infamous BURIAL - whenever the promoters fled with people's money, the local community did not know how to find them. That said, there are also areas where the promoters of BURIAL schemes worked with local collaborators to defraud depositors.

Although lots of people have lost and continue to lose money through ASCAs, the general feeling is that ASCAs are responding to a critical need. They provide access to financial services to the poor and a higher return for the net savers - often in the range of 10% per month. If the weaknesses were addressed most people feel that ASCAs would be a tremendous benefit to the local communities since most of them have no access to alternative savings and borrowing programmes.

[11] In Ibanda they are registered at the local division level.

2.1.5 Savings Clubs

Savings clubs are formed when individuals unite as a group to make savings contributions for a common purpose. This is often for Christmas celebrations in many parts of the country. A treasurer usually keeps the savings or sometimes a group account is operated by the group executives. Only 3% of the respondents indicated they used savings clubs. Of the few saving through this mechanism, 29% reported losses in savings clubs (Wright and Mutesasira, 2001). The relatively low usage of savings clubs is attributed to the losses in previous years where the treasury function has been abused or mismanaged, either by honest incompetence or competent dishonesty of the executive committees. The remaining savings clubs are reported to be less risky that ASCAs and RoSCAs but riskier than the formal sector.

In the absence of a formal bank account whose passbook records can be understood by all the members, some treasurers have been tempted to abuse or misuse the savings. Even when all members are literate, savings clubs have failed because members are not adequately vigilant to frequently verify the accounts of the treasurer. They realise too late that the treasurer has been secretly withdrawing and abusing their confidence. The end result is often losses to the savers. The other often reported risk is that robbers may attack the treasurer since it does not take long for it to become public knowledge that he or she has large amounts of money.

It is because of the above risks that members are reluctant to bring in new people and typically prefer to restrict savings clubs to between 10 to 15 individuals who are well known to each other.

2.1.6 Deposit Collectors.

Deposit collectors typically move around markets and collect small savings from their clientele (often on a daily basis) before refunding these as a lump sum, net of a commission, at the end of a specified period (often a month). Deposit collectors are not common in Uganda. Only 1% of the respondents used deposit collectors in Uganda and many have lost money (Wright and Mutesasira, 2001). The speed with which clients responded to an invitation by a new deposit collector after losing their savings at the hands of their previous one is remarkable. This is compelling evidence of the desperation and the willingness they have to pay for accessible and convenient financial services. The few deposit collectors the researchers found were in Tororo[12] and Owino/Nakawa markets in Kampala.

The deposit collector in Tororo, having operated for over 6 years with (at his peak) 2,200 clients was regulated out of existence by the town council. He was able to pay back all his clients and thus there is no evidence that any one lost their savings. The deposit collector in Owino Market[13], who serviced 200 people for a US$0.40 per month, lost all the savings with the closure of Greenland Bank in 1999. The customers with whom the research team spoke were understanding and forgave him because it was a loss not out of his negligence (Rutherford, 1999).

Nakawa Market vendors who suffered total losses with two previous collectors continued to respond to offers from subsequent deposit collectors because “it was a valuable service”. This clearly demonstrates that safety is only one of the considerations in choosing a financial service. Other considerations include the convenience and discipline provided by a mobile deposit collector who visits the market stalls everyday to collect the vendors’ deposits.

[12] The deposit collector in Tororo ironically operated across the road from two commercial banks whose mission was to serve the poor. One, the Coop Bank, has since been shut down by the Central Bank.

[13] This mobile deposit collector is still in business and has put 200 as his upper limit for services.

Box 6. Terrible They Were…. But We Needed Them!!

"We had two of them (deposit collectors). They both left with large amounts of money from over 60 savers. After the first one left, we persuaded one of us, who had a reputation of integrity, to start doing the daily rounds for a monthly fee because we liked the way it disciplined us to save. Each day she took away the money before I could spend it. It was surprising how much savings most of us had for the Christmas season. After losing money to the second collector we approached the market SACCO to start offering the deposit collection service which has been very instrumental in enabling many poor women to buy market stalls."

– A stallholder in Nakawa Market.

2.2 The Semi-Formal Financial Sector

In terms of savings lost, NGO-MFIs present one set of issues specific to the methods/systems they use, whereas the issues raised for SACCOs, Village Banks and FSAs are similar and so will be addressed in one category.

2.2.1 NGO-Microfinance Institutions

Table 5. NGO-MFIs

	Number of clients who saved this way in past 12 months	% of those using each service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year – Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
MFI group based savings & loans	189	69%	27%	203 ($127)	15 ($9)	7%
MFI individual based savings & loans	22	8%	36%	161 ($100)	37 ($23)	23%

Source: Wright and Mutesasira, 2001

NGO-MFIs (MFIs in Uganda are almost invariably registered as NGOs with the NGO board) have, to date, generally proved safer than any of the devices in the informal sector[14]. There are two types of NGOs namely the local and international NGOs. Local NGOs have tended to be small, often technically unskilled and more vulnerable to losses than the international MFIs. International NGOs on the other hand tend to have better trained staff and have proved better stewards of poor people's money.

Respondents reported cases where NGOs have mobilised users' savings promising to give them loans, but then disappeared. These cases have tended to be "brief case" NGOs with dubious registration. There were also reports of individuals posing as agents or employees of some prominent international NGOs that defrauded many people of their savings in Masaka and Iganga Districts. These unscrupulous operators promised to give clients housing loans, school fees loans, child sponsorship, etc. after a period of initial saving. The promises were never honoured and the individuals disappeared, with the savings they had mobilised. There are also cases of NGOs working as implementing agencies for the government poverty alleviation schemes that have run off with people's savings without extending loans. It is because of such cases that some respondents differed with those that have strong confidence in financial NGOs.

There was a strong feeling among respondents that NGO-MFIs were relatively safer when operated by personnel from other parts of the country. This is because outsiders are more likely to focus on the business and less on local social/political entanglements. International NGOs have typically proved safer because staff have typically been better trained on how to manage a financial services scheme. They generally have more clearly defined guidelines concerning who will have access to loans and how to deal with defaulters. They have the skills to determine the size of the loan and the rate at which the size of the loan is increased. This

[14] Women dominated the discussion of this sector since most men claimed ignorance of the affairs of NGOs indicating that it is in most cases the exclusive domain of women.

(in the initial stages at least) mitigates the repayment capacity risk. They tend to use the group guarantee mechanism, which has often ensured higher repayment rates thus protecting the NGO-MFI's loan portfolio. Nonetheless, this group guarantee mechanism does result in losses in savings when group members fail to repay and the MFI accesses the Loan Insurance Fund (i.e. mandatory client savings) to "balance out" the loan – indeed this is the most common and extensive source of losses amongst group-based NGO-MFI clients.

The rate of interest and penalties charged by MFIs is relatively smaller than that charged by ASCAs and so reduces the risk of default when a borrower is overwhelmed by the growth of debt service requirements due to missed payments. NGO-MFIs also tend to be run by well-educated and trained staff who, unlike ASCAs, are usually competent to maintain good quality records. So the risk of disagreement with records by the borrower and eventual default is considerably reduced. Most NGO-MFIs, unlike ASCAs, do not suffer from favouritism[15]. If a client keeps current with his/her payments, he/she will be rewarded with a loan according to the MFI's criteria. This has reduced default because people value access to these loans, which is only guaranteed by good performance. For this reason, a person's savings held by an NGO-MFIs are perceived to be safer because they are perceived to have fewer problems of default. Older members of many NGO-MFIs, however, argued that these institutions have caused massive losses for good clients especially under the solidarity group guarantee methodology. Most argued that by the time one gets into a fifth year with an MFI they have lost so much money through guaranteeing defaulters that they actually have to leave.

There is a common belief among clients, particularly in the Masaka and Mbarara districts, that registered financial NGOs enjoy a full government guarantee and are for this reason safer than informal arrangements. This misconception is arrived at because NGO-MFIs are registered with government. Registration with the government is misunderstood by many as meaning that the government has examined the NGO-MFIs, established their credibility, registered them and therefore given them a type of seal of approval for handling people's money. In some places, the users believed that the NGO-MFIs have been licensed and guaranteed by the central bank to transact business. This of course is not the case. However, MFIs' staff members have, in many instances, reinforced and exploited this misconception through their marketing campaigns.

2.2.2 SACCOs/Credit Unions, Financial Services Associations and Village Banks

Table 6. Community Based - MFIs (SACCOs/Credit Unions, Financial Services Associations and Village Banks)

	Number of clients who saved this way in past 12 months	% of those using each service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year – Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
TOTAL	63	23%	17%	247 ($154)	24 ($15)	12%

Source: Wright and Mutesasira, 2001

For the purposes of this report, SACCOs and village banks are treated under the same category as community-based MFIs (CB-MFIs). In most areas users were ambivalent about the safety of these types of institutions. The general experience, however, is that they have been weak and have caused losses. In terms of safety of deposits, they are considered more risky than NGO-MFIs but not as risky as ASCAs.

Several factors contribute to perceived deposit risk. The major perception is that SACCOs and village banks are managed by wealthier, influential members of the community who tend to take large loans and then default; which in turn means that the institution collapses with poor people's savings. The poorer members, who are usually powerless, are repeatedly promised repayment of their savings, but eventually give up pursuing the issue. According to the qualitative research, the only CB-MFI reported as having been able to fully repay depositors on demand was a multi-purpose co-operative that liquidated some of its physical assets

[15] Clients that dropped out of a prominent MFI in the Kampala area reported favouritism by the Loan Officer as the major reason for their exit.

in order pay depositors. In all other cases discussed in the focus groups, the defaulters are still at large and have not paid for the losses they inflicted to the CB-MFI.

Respondents everywhere indicated that the safety of a CB-MFI is a function of the character of the people in management. For instance, in Kayunga, Mukono District, there is one strong SACCO and three weak ones. The one run by a board and management of good repute and character is strong and attracts savings from many in the community. In spite of this, the respondents still long for a government-owned bank where they could keep long term savings operated by professionals, and supervised and guaranteed by government[16]. This tentative confidence explains why they do not maintain large balances with the SACCO. They use it only for maintaining liquid and emergency funds which they have never had difficulty accessing. Longer-term savings are kept in-kind or are sometimes transported many miles to Mukono town.[17]

It was reported that SACCOs have lost depositors' money because of the very low interest they charge on loans. Respondents believed that very low interest loans tend to make borrowers take credit without giving serious thought to how they are going to repay. Sometimes loans have been used to buy rather frivolous items and borrowers have had difficulty repaying. This has caused liquidity problems at the SACCO and eventually loss of depositor's money.

Many people have suffered loses to SACCOs because they are weak or have failed to collect their loans. In case of big loans, some SACCOs failed because they extended large, unsecured loans. In other cases, the CB-MFIs obtained very high value collateral for relatively small loans and so found it difficult to sell the debtor's assets to collect small obligations (mismatch of collateral to loan value). For example in one case it was found they could not sell off a neighbour's Ush.10 million house in order to recover Ush.1 million. These issues tend to progressively erode the portfolio until the SACCO suffers liquidity problems and is subsequently unable to fulfil demands for withdrawal.[18]

However, respondents clearly felt that SACCOs can have an important role in saving. Experience has shown that CB-MFIs that issue long term loans for capital investments have tended to suffer from default and consequently losses to depositors while the safest SACCOs are those that extend short term, small loans for supplementing school fees, hiring seasonal agricultural labour and responding to emergencies.

Employee-based SACCOs are also considered very safe because the borrowers' periodic repayments are directly deducted from the payroll. This reduces the risk of default and therefore the exposure of depositors' savings. This, according to respondents, makes this type of SACCO even safer than any formal bank.

Some SACCOs and some village banks are perceived to be safer than the informal sector devices because the management periodically receives training from Uganda Co-operative Alliance (UCA), the Central Bank's Development Finance Department and the UNDP Private Sector Development Programme, which are believed to improve record keeping, loan analysis and the general quality of management and therefore reduce the chances of loss of deposits.

[16] This location until a few years ago had branches of Uganda Commercial Bank and Uganda Co-operative Bank - both of which were closed

[17] Most communities interviewed are over 15 miles away from a bank.

[18] There are a lot of cases of these which are not viewed as out right losses because SACCO keeps promising to repay many years afterwards.

2.3 The Formal Sector

Table 7. Formal Sector

Financial services used	Number of clients who saved this way in past 12 months	% of those using each formal service	% of those who saved in the various schemes who had lost some savings	Average amount saved in the past 12 months – Ush.'000 across all savers	Average amount lost in the last year – Ush.'000 across all savers	% of average amount lost in the past 12 months (average lost/ average saved)
Formal banks	312	85%	16%	656 ($410)	18 ($11)	3%
Post office savings	60	16%	0%	428 ($268)	0 ($0)	0%
Other (insurance, pension, leasing)	17	4%	12%	419 ($262)	63 ($39)	13%

Source: Wright and Mutesasira, 2001

The formal financial sector is undeveloped in terms of capacity, outreach and financial products. In addition, in 1998/9 Uganda experienced the closure of several formal sector banks. In spite of all this, most respondents strongly believe that the formal financial sector provides the safest institutions. Respondents concentrated on the Uganda Commercial Bank, the late Co-operative Bank and Centenary Rural Development Bank. What was surprising was their silence about Post Bank Uganda, which does not seem to feature in their perceived financial landscape. While this issue was not extensively explored in this study, it is possibly important to note that the Post Bank Uganda's systems are typically very slow and that the organisation has a relatively high level of dormant accounts, often neglected and forgotten by the passbook holders.

Box. 7. To the Central Bank - Chasing After The Wind

Mary is a member of one of the MFIs in Jinja who lost Ush.250,000 when the Uganda Co-operative Bank was closed and later taken over by Standard Chartered Bank. "I presented my passbook to Standard Chartered Bank since they had taken over the Co-op Bank", she narrates. "A quick response explaining that I had only Ush.40,000 on the account was given by the young lady at the bank counter. She explained that she could not do anything for me because that is what her computer said. She calmed me down by referring me to the Coordinator at the Central Bank – Bank of Uganda. The next day found me at the coordinator's office. After a long wait, a lot of forms filled, plus lots of questions asked, I was advised to come back the next day. This happened several days before I quit. You see I was commuting 100 miles every day, spending over Ush.8,000 per day on transport and lunch, and keeping my business closed. It did not take long for me to realize that I was chasing after the wind. We were countless people at the Coordinator's office who lost money in this way. The wiser ones did not even bother checking with the Coordinator. There are others whose books were torn up right before their eyes. That is why I do not trust these banks any more."

Formal banks are usually perceived to be safe because even when they are closed, the Central Bank guarantees deposits regardless of how long it takes. Among the banks in the formal financial sector, the Uganda Commercial Bank was thought to be safest because it belongs to the government and therefore it is unlikely to default on its obligations to depositors because it has a government guarantee.

All the other banks that respondents were aware of enjoyed similar confidence with minor variations. The most important reasons included the strong security evidenced by armed policemen, a strong structure that houses a strong safe, skilled personnel and high quality record keeping. It is for these reasons that all the other financial institutions including FSAs, village banks, savings clubs, etc. use the formal banks to secure their excess funds.

However, the experiences of poor people in the context of the recent closure of banks presents a different view. One of the most interesting is that in spite of the consistent relative confidence respondents had in banks, most clients indicated that they had recently become nervous about the safety of their deposits. There were many reports of people, especially in Mukono District, who have (so far) failed to collect their money in the wake of the closure of the Uganda Co-operative Bank Ltd. Mary's story (box 7) is typical of customers (especially those with relatively small balances) who were repeatedly sent back and forth until they realised that they were losing more money by pursuing their savings than if they recovered their savings balances. These people have lost confidence in the formal banking sector. There are also many cases in Kampala District of people who received less money than the balances indicated in their passbooks and claim that the officials at the bank have failed to provide a convincing reason for the variance. Because of these experiences, some clients felt that formal sector banks are just as risky as any other devices.

3.0 CONCLUSIONS AND RECOMMENDATIONS

The foregoing discussion makes it clear that the poor suffer huge losses in the informal sector. Understanding the dynamics of their risk environment is a crucial consideration for developing appropriate policies and regulations governing financial services for the poor. Conservative regulation can constrain the poor to only one option **-** the informal sector – the high relative risk of which adversely affects the very people the laws and regulations intended to protect.

Safety of deposits for the poor is extremely important, however, their decision on where to keep deposits has considerations beyond safety. Additional reasons include: speed of transaction, convenience, accessibility of payment services and loans, and sometimes, rate of return. These additional considerations lead the poor to diversify their portfolio and often lead them to deposit money in an instrument perceived to be risky in order to have access to the desired features.

In light of these conclusions, it is our recommendation that regulators take time to understand the poor person's risk environment before recommending well-meaning policies that might simply drive the poor into riskier options. Central Banks and policy makers should be open to innovation and alternative financial service arrangements, which do not necessarily fall under their supervisory jurisdiction but continue to provide what is perceived to be relatively safer financial services to the poor than the informal sector (Wright and Mutesasira, 2001).

Several complementary approaches are required to increase the safety of poor people's deposits, and thus increase savings mobilisation in developing countries. Firstly more creative energy, effort and investment is required in assisting regulated and supervised formal sector financial institutions (particularly Postal Banks which were typically created for this purpose) deepen their outreach to offer cost-effective savings services to poor people. This is likely to be more feasible in economically active and population dense environments and should therefore start in urban areas.

Secondly, creative regulatory and supervisory regimes (such as that currently under development in Uganda) are required to allow competent, profitable MFIs to begin to offer savings services through their delivery systems and networks. These MFIs will provide important competition for the more traditional formal sector banks in the urban areas and should be able to begin to extend outreach into less population dense rural areas. In addition, Central Banks will have to look at options for even more extensively tiered regulatory options (discussed in more detail in Wright and Mutesasira 2001) that might (*inter alia*) allow MFIs not yet formally supervised to collect deposits provided that these are immediately banked in supervised formal sector institutions pending clients' demand for their withdrawal. These MFIs would not be permitted to intermediate the savings they mobilise into loans. MFIs interested in such arrangements will have to work hard to differentiate these voluntary savings from the compulsory loan insurance funds they extract as "compulsory savings" and protect the voluntary savings from erosion by group guarantee.

Finally, if remote rural communities are to be served effectively, development organisations will have to put more emphasis on investing in developing and disseminating simplified systems to help people manage community-based MFIs, ASCAs and RoSCAs with the aim of making them safer and linking them to banks.

Technical support and training in record keeping is crucial for strengthening the informal institutions and consequently reducing risk exposure. CARE International and FAO are making advances in this area and lessons from their experience need to be sought. Establishing and supervising ASCA and RoSCA groups can be done for a fee. There is evidence in Eastern Uganda[19] and Kenya[20] that variants of ASCAs are already paying a local NGO to offer them on-going technical assistance[21].

Once again, it is time for the microfinance industry and the central bank to think "outside the box" and understand the issues from the perspectives of the end-user. Failure to do so could mean that well-intentioned regulations will trap poor people in the relatively high risk informal sector and prove once again that "it is expensive to be poor".

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[19] PACODEF is a local MFI operating in Eastern Uganda

[20] SAGA Thrift and Enterprise Promotion Ltd. and Partners for Productivity (documented in ***MicroSave***'s "Informal Sector Finance Systems: What the MicroFinance Industry Can Learn From Them")

[21] FSA International has a supervision agreement with the local FSA which includes remittances of 10% of gross revenue per month to FSA International in exchange for training and supervision