Assessing the Sustainability of Savings and Credit Cooperatives

Markus Distler (markus.distler@die-gdi.de) and Daniel Schmidt (daniel.schmidt@die-gdi.de)\textsuperscript{1}

1. Introduction

Microfinance has been centered on providing loans to financially excluded people in the past, while savings have been neglected. In the last years this approach has been criticized, fostered by a microfinance crisis in India and other low-income countries (CGAP, 2010a). Many experts argue that it would be advisable for the poor to save first and then invest the money (CGAP, 2010b). The provision of save and reliable saving opportunities is of central importance for both the poor and the microfinance institutions (MFIs). In Uganda, savings and credit cooperatives (SACCOs) as financial intermediaries, channeling savings into loans, provide saving opportunities for the poor, especially in the rural areas, but further improvements are necessary to make their services more efficient and sustainable.

Evidence shows that poor people are looking for opportunities to save their surplus income in case of emergencies or to be able to undertake larger investments in the future without having to take a loan (CGAP, 2006). There is a high potential to mobilise savings among low income people in Uganda. However, poor people used to mostly rely on informal – often insecure – ways of saving, such as saving circles or hiding money under the mattress (Wright and Mutesasira, 2011). Providing financially excluded people with secure opportunities to save can minimize the losses, which arise from the insecure ways of savings, and therefore empower the poor financially. Furthermore, savings can help to access loans from financial institutions. Financial institutions are more likely to give loans to customers that have a history of saving within their institution. However, small savings have been neglected by the MFIs in the past, as other funding sources were preferred (CGAP, 2010b).

2. SACCOs in Uganda

SACCOs are member-based institutions, that intermediate savings into loans. SACCOs are usually rather small, independent financial institutions. The business model of most SACCOs is to collect savings from their members and to intermediate them into loans. This enables the rural and poor population to deposit savings as well as to take loans. Only members can use the services of SACCOs, as the Ugandan law prohibits SACCOs to take savings or lent out money to the public. The members can participate in annual general meetings and elect a board of directors.

The government of Uganda has subsidized the founding of new SACCOs all over the country. Newly established SACCOs can apply for a start-up grant from the government owned apex-

\textsuperscript{1} Markus Distler and Daniel Schmidt are postgraduate Master students from the German Development Institute (DIE) in Bonn. For their Master thesis they conducted in March and April 2011 a national survey of 46 SACCOs in Uganda
instituti
on Microfinance Support Centre (MSC). MSC also gives out interest free loans to the SACCOs or other subsidized loans. In addition to grants and loans SACCOs can also receive operational support from the government. The government pays salaries and rent for the first two years after the start-up. These support schemes are important elements of the government’s “One SACCO per sub-county” initiative, which is a part of the wider program “Prosperity for All” (State House, 2007).

In contrast to other financial institutions, the SACCO sector in Uganda is not regulated by the Bank of Uganda (BoU). Commercial banks and credit only institutions are prudentially regulated through the FIA, while the microfinance deposit taking institutions are prudentially regulated through the MDI Act. SACCOs are regulated through the Cooperative Societies Act, but this act is not sufficient for financial institutions. Thus, SACCOs are the only financial institutions that are collecting savings but that are not prudentially regulated by the BoU (AMFIU, 2005).

3. Assessing the Sustainability of Savings- and Credit Cooperatives (SACCOs) in Uganda

Government of Uganda (GoU) asked the German Development Institute (DIE) to conduct a survey on the current position of SACCOs in the financial system in Uganda. In order to have an empirical basis for decisions concerning regulation, supervision and support for SACCOs, the government decided to entrust the DIE with the task of assessing the sustainability of national SACCOs in light of declining subsidies in the future.

The team conducted research in six areas of the country and visited 46 SACCOs in order to evaluate their financial, institutional and social performance. In order to gain a complete picture of the situation, the team aimed to collect a representative sample of the SACCO sector in Uganda. Together with the MTTI the team ensured that large (cluster 1), medium (cluster 2) and small (cluster 3)\(^2\) SACCOs were represented in the sample and that the SACCOs are situated in different areas of the country. The survey included not only the different regions of the country but also rural, peri-urban and urban SACCOs (Wolff et.al., 2011).

4. The Findings

Social Performance

Despite considerable downscaling efforts by tier 1 to 3 institutions and the increasing competition that SACCOs hence have to face, in many rural areas SACCOs remain the only formal financial provider that clients can access regularly. SACCOs fulfil a very important outreach function for expanding access to financial products and services.

Financial Performance

\(^2\) Cluster 1: SACCOs with an asset size above/equal to 1 billion UGX; Cluster 2: SACCOs with an asset size under 1 billion and above/equal to 100 million UGX; Cluster 3: SACCOs with an asset size under 100 million UGX
Although the financial results of most of the SACCOs surveyed do not seem very alarming, several issues might put their financial sustainability at risk in the future. Many SACCOs, especially smaller ones, are over-dependent on subsidization. The quality of the SACCOs’ loan portfolio, a main indicator for the capability of lending institutions, seems to be another critical point that threatens the viability of many SACCOs. Due to the enormous demand for financial products in rural areas (in particular loan products), the SACCO sector as a whole is growing considerably. However, the growth pattern of many smaller SACCOs seems uneven since they have difficulties to attract savings deposits from their members.

Institutional Capacity

Most SACCOs hold annual general meetings (AGMs), in which the members can take part and elect the board of directors. However, in many SACCOs, internal control suffers from a lack of capacities of board members. The apex institutions provide training for management and staff to improve their capacities, but the training is not unified and standardized. The reporting structure between the management and the board of directors is still weak in most SACCOs, as no written evidence of the meetings exists. Most SACCOs also do not have a Management Information System (MIS), which makes it difficult to monitor the performance adequately.

5. The Capability of SACCOs to attract savings

Member deposits contribute to the sustainability of SACCOs. In general, MFIs are increasingly providing formal saving opportunities. They have realized that savings, especially long-term deposits, are a cheap and reliable refinancing tool and can increase their funding base – thereby contributing to their sustainability. SACCOs are practically excluded from capital markets and wholesale loans; loans from other lending institutions would only be available at prohibitively high interest rates. The only external financier for SACCOs is the state-owned MSC that provides loans at interest rates that are way above the interest rates depositors demand.

SACCOs have comparative advantages over other financial services providers. People in rural areas often lack financial services providers that lie within range and are regularly accessible. SACCOs with their “brick and mortar” structure are often the only formal financial institutions people in rural areas can access; this quasi-monopolistic position in the countryside gives SACCOs a distinct comparative advantage over Commercial Banks or MDIs that are mainly present in the urban areas in Uganda.

A lack of savings is a major bottleneck to growth for SACCOs. Almost all SACCOs visited mentioned they are not able to attract sufficient savings from their members to meet the high demand for loans and to grow fast. Fehler! Verweisquelle konnte nicht gefunden werden. shows the SACCOs’ member deposits in relation to the share capital from their members, an indicator of the capability of SACCOs to attract capital from their members apart from the

3 With the exception of “Start-up Loans” that MSC provides without interest for newly established SACCOs. MSC charges 9 per cent p.a. for “Agricultural” and “Environmental Loans” and 13 per cent p.a. for “Commercial Loans”.
member shares bought by the members. The numbers clearly show that bigger SACCOs are better able to attract member savings. In cluster 1, the SACCOs’ deposits are more than six times higher than their share capital; in cluster 3, the SACCOs’ deposits are only 1.8 times higher than their share capital.

**Figure 1: Deposit-Share Capital Ratio**

![Graph showing Mean Deposit to Share Capital Ratio per Cluster Group]

Larger SACCOs attract more member savings than smaller SACCOs because they are able to offer more attractive savings products. In general, most of the SACCOs examined do not offer any monetary reward to their members for putting savings into the SACCO. A main motivation for members to save at the SACCO is often to have access to loans in the future since SACCOs normally link the maximum accessible loan size with an amount of compulsory savings that a potential borrower has to hold at the SACCO. However, it was observed that bigger SACCOs are able to offer better incentives to savers apart from the access-to-loans argument. They offer higher nominal interest rates on current and term deposits than smaller SACCOs and term deposits play a more important role for the funding of bigger SACCOs. With regard to current deposits, only Cluster 1 SACCOs offer considerable nominal interest rates. In contrast, table 1 illustrates that interest rates on term deposits offered by all three clusters seem somehow attractive. However, relative to total deposits term deposits only play a significant role for SACCOs in Cluster 1 and 2.

**Table 1: Interest rates on deposits, term deposits/total deposits**

<table>
<thead>
<tr>
<th>Interest on term deposits</th>
<th>Sample</th>
<th>Cluster 1</th>
<th>Cluster 2</th>
<th>Cluster 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10.1%</td>
<td>8.64%</td>
<td>11.25%</td>
<td>8.64%</td>
</tr>
</tbody>
</table>
Well run financial institutions – backed by proper regulation and effective oversight – can provide convenient, secure, and reliable savings opportunities. To tap the savings potential of the poor, formal financial institutions such as SACCOs must find ways to combine simple and easy to access financial products with good governance and proper liquidity management. Accessibility is crucial; especially people in rural areas lack places within range to deposit or withdraw money. Also, governance is important; people need to trust the financial institution they entrust their savings with. Furthermore, external supervision based on prudential regulation enhances credibility of deposit taking financial institutions (BIS, 2010) Individual micro savers lack both resources and incentives to check and monitor their MFI or SACCO themselves. Therefore, the government is in charge of setting up a regulatory framework and provide sufficient resources to supervise deposit taking financial institutions and guarantee minimum prudential standards in the financial industry.

Proper regulation and supervision is overdue and should be the next step to enhance the sustainability of the SACCO sector. SACCOs have long been overlooked by regulators. The Cooperative Societies Act is not suited to regulate deposit taking financial institutions. The fact that SACCOs intermediate their members’ savings calls for prudential regulation and external oversight in order to avoid loss of savings. In particular, stricter requirements for opening a SACCO are needed. This has been realized by the Ugandan government so that a regulatory and supervisory framework for SACCOs is being set up.

6. Conclusion

SACCOs have played an important role as financial services providers in rural Uganda, giving the low income population the chance of accessing financial services. However, more could be done to strengthen the role of SACCOs as financial intermediaries. In particular, their role as absorber of savings has great potential to improve the well-being of the rural population. Bringing the focus on microsavings would lead to more sustainable MFIs and help poor people escape poverty. Policy makers should contemplate orienting microfinance policies – regulation and subsidization – towards microsavings (Roland Berger Strategy Consultants, 2011).

In the future, traditional branch banking models will increasingly be complemented by innovative ways of banking. Mobile phone banking as a form of branchless banking, for instance, will play a greater role, enabling people to send, receive, and deposit money. New
technologies entail new challenges for SACCOs that have to adapt to the new competitive environment in order to keep their comparative advantage in rural Uganda. It is particularly questionable whether the SACCO sector as it is today, characterized by many small stand-alone SACCOs (and only few large and mature SACCOs), is viable in the future; a process of consolidation might be required to enable SACCOs to reap economies of scale and help SACCOs stay attractive to their traditional client base.

**Literature**


Wolff, et.al (2011) “Assessing the sustainability of Savings and Credit Cooperatives in Uganda”, German Development Institute, Bonn.