Pacific Financial Inclusion Programme
focus notes
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BALANCE OR BREAK?

Charting a Course for Savings Group Sustainability

Across much of the Pacific, including the Solomon Islands and Timor-Leste, there are financial groups or 'clubs' in many villages. They play a vital bridging and education role in financial inclusion. They deliver basic services to people who may not have the skills to use mobile money accounts, or access to banks. Just as important, these groups help people to learn basic financial management skills, priming them for more formal financial inclusion in due course. However these groups often stop functioning, resulting in service interruptions and a lost opportunity for household financial progress. They may also fail, fracturing member trust in both the cash economy and the financial system.

Ensuring service quality and continuity, preventing failure, and triggering sustainable replication has large pay-offs for people in remote areas, as well as for policy-makers and other stakeholders committed to financial inclusion.

To attain these goals practitioners, donors and policy-makers should ask themselves one strategic question, and then work through the practical implications. Should their groups balance, or break?

Breaking and Balancing

Balancing and breaking are both solutions to the same problem: they validate the accuracy of information prepared within financial organizations. When successful, this aligns the incentives of those who prepare the information with others who use it, such as consumers, banks or external investors. However, these solutions target very different user segments. **Balancing** is an accounting practice that emerged to serve cultures where mass literacy was becoming normal. It was first popularized by Lucia Pacioli, a Renaissance author born in 1447, shortly after the invention of the printing press.

Table 1 summarizes the similarities and differences between breaking and balancing.

Table 1: Balancing and Breaking, Compared

	Breaking ('action audit')	Balancing
Segment	· Oral cultures	· Literate cultures
Definition	· 100% distribution of the capital of the group to the members · This distribution includes all savings and all interest, profit · The group dissolves and ceases to exist · The capabilities of the members to organize and run a group continue, and people often re-start	· Confirming that the book assets of the Savings Group (SG) are actually there. · Involves tests that determine whether any money has been lost during operations · Can be conducted from SG records by SG members or external parties · Triangulates SG records with other sources of information, for example member-level
Benefits	· Speeds up household capital accumulation through large pre-planned withdrawals · Reduces risk of loss by keeping the amounts that must be protected by the SG small · Protects members' savings · Answers members' unasked question: "where is my money?"	· Protects members' savings · Permits SGs to manage larger capital amounts · When records are accessible and most members can read them, answers members' question: "where is my money?" · Can lead to rapid growth in capital due to the power of compounding interest and profit over time · Build human and institutional capacity for deeper integration into the financial system

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Breaking also validates organizational information, but is adapted to the needs of oral cultures. All the organization's resources are distributed to shareholders at a pre-agreed date, providing a clear answer to their questions about their investments, while limiting their risk of loss to the time of the venture. Breaking has been described more formally as **'action auditing'[1]** because it is the oral analogue to the text-based audits that are routine in modern economies.

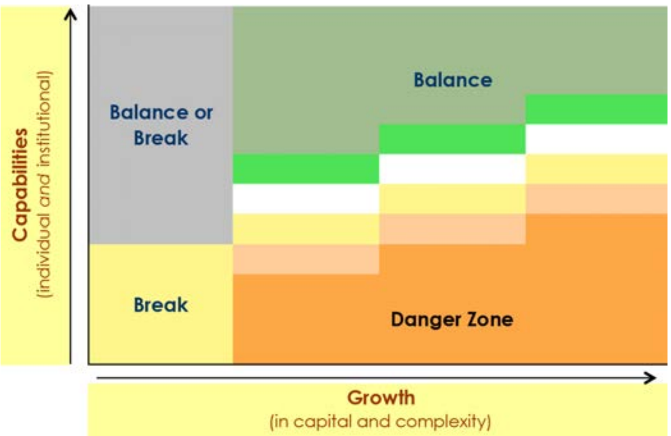
Breaking has a very long history. Equity investments in the era of Pacioli (and before) were often time-limited, bounded for example by the time required for a round-trip to a foreign port or ports, and the acquisition and sale of the related goods.[2] Today there are time-limited ROSCAs ('rotating savings and credit associations') in oral villages on every continent. No one knows when they started, but there is documentary evidence dating to 1275 in Japan[3]. Beginning in 1990, NGOs began to seek greater financial inclusion in oral communities by designing time-limited 'savings groups' that innovate on informal templates.[4]

Who Should Break, and Who Should Balance?

When should savings groups be designed to balance, and when should they be designed to break? **Diagram 1** roughs-out the key variables and constraints.

Where capabilities are low it is better for savings groups to break. Specifically, if there are not 6-8 reasonably literate individuals willing to serve in both membership and leadership roles, the savings group should always break.

Diagram 1: Should It Break or Should It Balance?



Once savings groups pass a certain minimum threshold of size in assets and complexity, they must balance, and balance effectively, or their members' savings will always be at risk. A useful working maximum in Timor Leste or the Solomon Islands would be in the range of US$5,000 to US$10,000. Any group without the capacity to balance should break before it reaches this threshold.

Literacy is low in many Pacific countries, including Timor-Leste, where census data indicates an adult literacy rate (age 15+) of 58% in 2008-12, with a substantial gender gap (53% of adult women are literate).[5] Studies in four provinces in the Solomon Islands, including the national capital region, have found functional literacy rates to be no higher than 34%.[6]

The Danger Zone

When a savings group has more than US$5,000 to US$10,000, but does not have at least 6-8 functionally literate individuals, it is in a danger zone. In the Solomon Islands NGOs have spent decades forming permanent savings groups and 'clubs' in remote areas. These are the villages and communities where literacy rates tend to be lowest. NGOs in Timor-Leste have organized many savings groups since independence in 2002. All were permanent until the introduction of time-limited models in 2014.

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1 The terminology here follows Stuart Rutherford. The Poor and Their Money. Oxford University Press, Delhi, 2000.

2 Many early examples were documented in Mesopotamian tablets, including the dealings of Ea-Nasir, a merchant of Ur who conducted maritime ventures to Dilman on the Arabian peninsula (van de Mieroop, Marc. Society and Enterprise in Old Babylonian Ur. Dietrich Reimer Verlag, Berlin, 1992.) Time-limitation restricted capital accumulation, so it is not surprising that it was a merchant (Amatino Manuci, of the Florentine firm Giovanni Farolfi & Co.) who is the first known to have used double-entry book-keeping, in 1299.

3 Ardener, Shirley. *The Comparative Study of Rotating Credit Associations*, The Journal of the Royal Anthropological Institute of Great Britain and Ireland, Vol 94 (2), 1964, p. 204.

4 The first breaking savings groups engineered by NGOs were formed by CARE in Mali in 1991. See for example Allen, Hugh. *CARE International's Village Savings and Loan Programmes in Africa*, CARE, 2002.

5 UNICEF maintains the global literacy database, based mostly on national census data (http://www.data.unicef.org/education/literacy). Data for the Solomon Islands, and for the Pacific region as a whole, are not available.

6 The data is summarized in a recent World Bank report, which adds "65–75 percent of primary school completers were not functionally literate." Close, Stephen. Skills for Solomon Islands: Opening New Opportunities, World Bank, Sydney, 2012, p. 4.

Permanent groups in these remote settings can usually survive for a few years. In the first years they receive grants and coaching in book-keeping, until they are 'mature' enough to become 'independent'. With the right leadership and deep community commitment, they may continue offering useful financial services for decades. But such stories are exceptional. In most groups, by the time the NGO leaves both the money and the complexity of the books are either unmanageable or are rapidly becoming so.

Savings groups respond to this dilemma in several ways. Sometimes a few powerful members decide to borrow and not repay. Sometimes everyone freezes. Whoever has money in their pocket, keeps it. A few innovative groups discover again the millennia-old answer: they break against the advice of their trainers, and hope no one notices their 'failure'.

During field work last year, our team attempted to balance the books of 28 savings groups distributed widely around Timor Leste. **Table 2** illustrates the result for the eighteen for which it was possible to assemble a balance sheet. Data for the other ten was too poorly kept: although most were less than three years old it was already impossible to determine what assets really existed.

Tight-rope walking in Timor-Leste

Table 2: UNCDF Sample of Savings Groups in Timor Leste, 2014

Sources and Uses of Cash ($US)			
Cash		**Liabilities**	
Box	8,136	Savings	23,577
Bank	-	Borrowing	-
Loans		**Equity**	
To members	25,066	Shares	6,382
To non-members	100	Grants	750
[less: doubtful loans]	-408	Retained earnings	5,043
Total	**32,894**	**Total**	**35,751**
Number of SGs	18	Number Balanced	9

Of the eighteen with functional records nine balanced, while for the others assets are systematically less than Liabilities + Equity. For example, loan balances were sometimes reduced by record-keepers, but the offsetting savings and profit accounts were not reduced to match. Doubtful loans are certainly underestimated in these cases, and in some cases assets may already be less than the savings contributed by members. There is no reason to expect this trend to reverse.

For a permanent savings group, 6-8 literate individuals is a minimum – it is not automatically enough. Balancing -- confirming that the book assets of the savings group are actually there – is not easy. NGO policy in both countries has generally involved teaching villagers to keep books up-to-date indefinitely on a running account basis, without balancing. This is inherently unsustainable. Sooner or later errors will be missed, and over time could lead to serious and even disabling disputes.

Rural Credit Unions

Unlike other savings groups, small rural credit unions are designed to balance. They emerged in the Solomon Islands in the 1980s, and quickly evolved into a kind of permanent savings group locally called a 'savings club'. They also emerged in post-independence Timor-Leste a decade ago, based on an Indonesian-style model called 'UBSP'[7]. Practitioners encouraged the largest groups possible, and villagers were taught how to balance monthly. Practitioners also taught these organizations to discourage withdrawals, arguing that more capital would accumulate, and that record-keeping would be simpler, without them.

[7] Literally a 'joint saving and loan venture' (Bahasa: usaha bersama simpan pinjam).

The balancing system in the Solomon Islands proved too complex for book-keepers, and the villages proved too small and far apart to make large groups, or federating between groups, work. In both countries members who could not withdraw funds when needed, lost confidence after a year or two, and stopped depositing.

While the villages are larger and less isolated in Timor-Leste, town-based UBSPs with many educated members fare better than village-based ones. After a few years some have shifted towards more liberal withdrawal policies, resulting in enhanced stability.

Protecting Savers and Widening Financial Inclusion

What are the practical implications of the balance-or-break trade-off? Governments and central banks want to expand financial inclusion. They also want to see poor citizens, many of whom are illiterate, protected from loss of savings and other financial abuses. These priorities encourage a liberal approach to regulation: minimizing administrative burdens placed on savings groups, and channeling protection measures through features of savings group design, and practitioner capabilities.

UNCDF tests a simple breaking system in the Solomon Islands during a workshop

Breaking addresses this government concern by creating a potent instrument for consumer protection in remote areas where few other instruments can achieve these goals. NGOs and practitioners should be cautious about an overzealous drive towards permanence. As villages develop, human skills will increase, and permanence can evolve naturally. Above all the 'mushy middle' should be avoided: savings group designs that neither balance nor break. Such designs are inherently unsustainable.

Three potentially high-impact opportunities are clearly evident in the current situation.

- Many permanent savings groups of all varieties could be liberated from the unattainable logic of balancing and guided towards the simple and attainable logic of breaking. NGOs could aid this process greatly by designing, piloting and scaling up appropriate breaking-protocols.
- Both nations need a simple balancing and reporting system that can encourage service quality, financial sustainability, transparency in oral contexts and acquisition of key skills by oral account users. Such a system could form the basis for simple and flexible national reporting systems for balancing groups.
- As the required skills develop in a community, opportunities will emerge for NGOs to work with breaking savings groups to help them shift towards permanence. This process should be designed as a separate system, with a manual and skilled trainers to lead to the process.

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