

# **INFORMAL FINANCIAL GROUPS IN TANZANIA**



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# 1. INTRODUCTION

The Bank of Tanzania (BOT) in collaboration with the Financial Sector Deepening Trust (FSDT) conducted the IFGs assessment in Tanzania in order to gain deeper insights into their evolution, nature, characteristics, management and operational features.

As a distinctive sub sector, IFGs deliver certain characteristics products, face certain distinctive risks, and present certain opportunities. The study was done by DAI as commissioned by BOT and FSDT to carry out a comprehensive assessment of IFGs in Tanzania.

To accomplish this assignment and achieve the overall purpose of this study, DAI consulting team developed focus group discussion guidelines, interview tools, and a sampling frame. They carried out stakeholder interviews and visited and assessed a sample of operating IFGs across 11 geographical areas of Unguja Kati, Pemba, Dar es salaam, Tanga, Kilimanjaro, Kagera, Tabora, Iringa, Lindi and Mtwara.

## DEFINITIONS OF KEY TERMINOLOGY

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**ACCUMULATING SAVINGS AND CREDIT ASSOCIATION (ASCA):** ASCAs are IFGs that keep cash between meetings. This accumulation provides them with the capacity to lend the money out at a time convenient to their members, and to earn interest on this service. Accumulation can in principle take place indefinitely, resulting eventually in substantial accumulated pools of capital. But this flexibility also requires more written records, which are hard for many members to monitor. Cash must be stored somewhere, exposing it to the risk of theft, loss or misuse. The more complex an ASCA becomes, and the poorer or more remote the community, the greater the vulnerability.

**CYCLE:** In IFGs, a cycle refers to the period between the first member deposits and the final capital distribution. The action audit cycle is distinctive to IFGs. It serves as an informal sector substitute for processes in the formal sector such as balancing, reporting and auditing of financial accounts; processes that are often beyond the compliance capacities of local institutions and individuals.

**ENGINEERED ASCA:** An engineered ASCA is one that has been designed by individuals or organisations in the formal sector, usually to expand financial inclusion as well as to address other goals, such as reducing the risk of informal finance, teaching financial literacy, or delivering supplementary health or environmental services. Engineered ASCAs are promoted by external agents (usually NGOs), and their members are trained on the implementation of a formal package of rules and practices.

**HYBRID ASCA:** An ASCA that results from the mixing of multiple tools and solutions that were originally native to distinctive IFG models, such as upatu, savings and internal lending community (SILC), a microfinance institution, a traditional practice or even an enterprise system. Hybridisation is a function of the evolutionary process in IFGs, whereby people adopt new practices and methods and abandon older ones in a quest to succeed. For example, an unfamiliar record-keeping system or financial product may decay and be replaced by a traditional practice, or a traditional practice replaced with a newly engineered one.

**NATURAL ASCA:** An ASCA that emerges without external engineering from formal sector designers. Natural ASCAs emerge spontaneously, or are transmitted from one community to another through trade, migration or informal exchange.

**ROTATING SAVINGS AND CREDIT ASSOCIATION (ROSCA):** ROSCAs are IFGs that keep little or no cash between meetings. ROSCAs offer saving and loans products, but these are unfunded: that is, the availability of funds relies not on keeping cash available, but on prior commitments made by IFG members. Because ROSCAs do not keep cash between meetings they need not keep records.

**UNFUNDED FINANCIAL PRODUCT:** A financial product that relies solely on member commitments to pay, not on cash storage or liquidity management practices. For example, ROSCAs provide a cash hand-out to one member at every meeting, receiving the required funds from the members on the day of the pay-out, based on a pre-agreed commitment. Social funds and funeral financing can be funded through prior cash accumulations, or unfunded – based solely on commitments made by members to contribute should a pre-agreed event take place.



## 2. METHODOLOGY

The research was qualitative. The goal was to understand the evolution, nature, characteristics, management and operational features, products and risks of IFGs.

The research team concentrated on a random selection of 11 communities in Tanzania, across 9 selected regions of the mainland and 2 in Zanzibar.

In each community the team attempted to identify every operating IFG, categorise them, and understand them. The team also interviewed with stakeholders such as local government officials, and key informants straddling the local IFG sector and local MFI representatives.

The team also conducted three types of focus group discussions: on the evolution of the local sector, on the networks and relationships between different sectoral actors, and on the structure of IFG product offerings.

Analysis of IFG objective changes in product features and the capabilities of leaders and members is done to better understand IFG governance, management and operations. This can be explored in focus groups and in interviews.

The research team used the following methodologies across the 11 communities:

#### INFORMAL FINANCIAL GROUP (IFG) PROFILE

- Checklist

#### VILLAGE FINANCIAL MARKET (VFM) PROFILE

- Checklist

#### DIRECT OBSERVATION OF IFGS

- Checklist + Discussion Guide

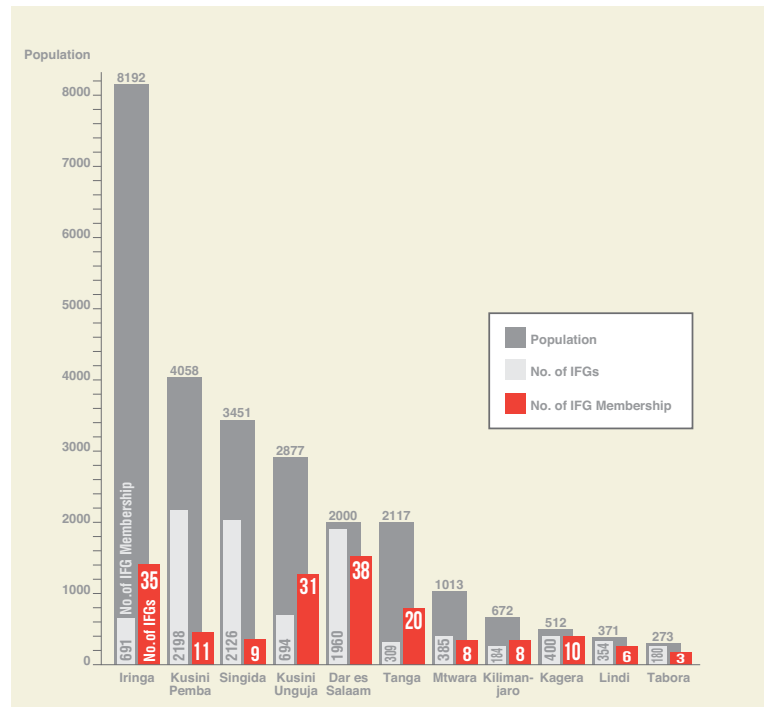
#### FOCUS GROUP DISCUSSION GUIDES

- Evolution of the village financial market (with IFG members)
- Evolution of product features (with IFG members)
- Evolution of leadership capabilities (with IFG leaders)
- Mapping of the village financial market (with IFG members)

#### VILLAGE INTERVIEWS

- Veo's and chiefs
- Fomer members

### IFGs in sample communities







### 3. WHAT ARE INFORMAL FINANCIAL GROUPS (IFGS)?

*“10.6 million Tanzanian adults continue to access finance informally”*

IFGs represent the various forms of financial transactions, products, and services that individuals agree to participate in. Informal finance relies on traditional, often unwritten norms, rules and practices. Finance is defined in terms of cash and cash-based accounts. IFGs often transact in noncash stores of value as part of their operations. In Tanzanian communities today, whether in urban or in remote rural areas, there are many IFGs, usually of several different types. These are delivering financial services—and some order of financial inclusion—to millions of Tanzanian households.

IFGs emerge in Tanzania where the cash economy, and the practices associated with using cash as a means of payment and store of value, are spreading ahead of the effective reach of the formal financial sector.

In the absence of more capable financial institutions or suitable formal financial products, IFGs are an entrepreneurial response to the diffusion of cash and ways to use it. They create enough hierarchy and coordination to partially correct some market failures in saving, lending and insurance.



For example ROSCAs form usefully large sums of money from small and irregular household cash flows, and funeral societies form usefully large sums of money or in-kind resources to self-insure against death or severe illness of family members. IFGs overcome these market failures with extremely limited resources, relying primarily on local norms of reciprocity and cooperation, the proclivity of humans to consolidate repetitive behaviours and habits, and village authority structures.

Informal financial services promoted through local, national and international NGOs are conducted with varying levels of quality and most of these actors work in isolation, with little experience sharing or communication among them (FinScope, 2006). With VSLAs and VICOBA, the management and governance of the associations are in the hands of the members themselves, initially, administered by implementing organisation in terms of capacity building of members and leaders through training, guiding and mentoring (Allen, 2006).

## CHARACTERISTICS THAT DIFFERENTIATE IFGS:

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### Cash Accumulation

**ROSCA:** Cash is not accumulated between meetings. Cash is collected and distributed at meetings for a pre- agreed purpose. There is little need for record keeping.

**ASCAs:** Cash is accumulated between meetings. The collection and distribution of cash do not necessarily match. The need for record keeping is important.

### Time Limitation

**Temporary:** All capital is distributed periodically to all members and the group is dissolved. Most ROSCAs and ASCAs operate with this model.

**Permanent:** There is no periodic distribution of capital to all members. It is important to remember that capital may also be in kind (non-cash). Most funeral societies operate with this model.

### Capital (Store of Value)

**Cash:** Capital is cash based where contributions and benefits are both in cash. This is the model for most ROSCAs and ASCAs.

**Mixed (cash and non-cash):** Capital goes beyond cash and may include labour, food, community activities, etc. Funeral societies collect cash but distribute non-cash benefits.

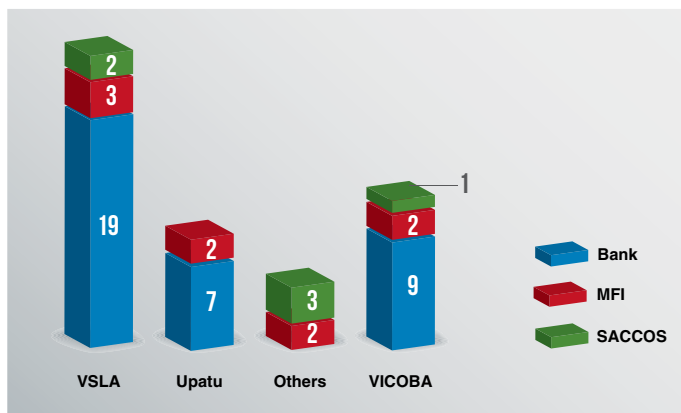
Because IFGs use mixed stores of value, interest rates can be an unreliable signal in the informal sector. This is because price is a small part of the total transaction cost.



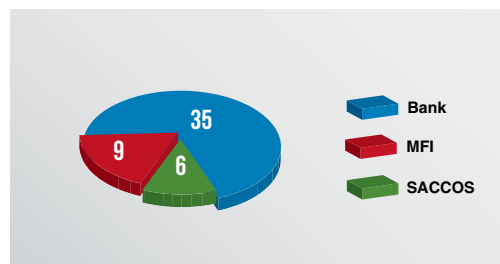
## 4. RESEARCH HIGHLIGHTS

The research findings show that IFGs penetrate into virtually every household in Tanzania, and that many households hold multiple memberships. As sampling was random, but representative of key variations in Tanzanian community life, from the suburbs of Dar es Salaam to remote villages around the country, it is likely that these findings reflect the national situation reasonably well.

### Financial Inclusion by type of Institutions attended by IFGs

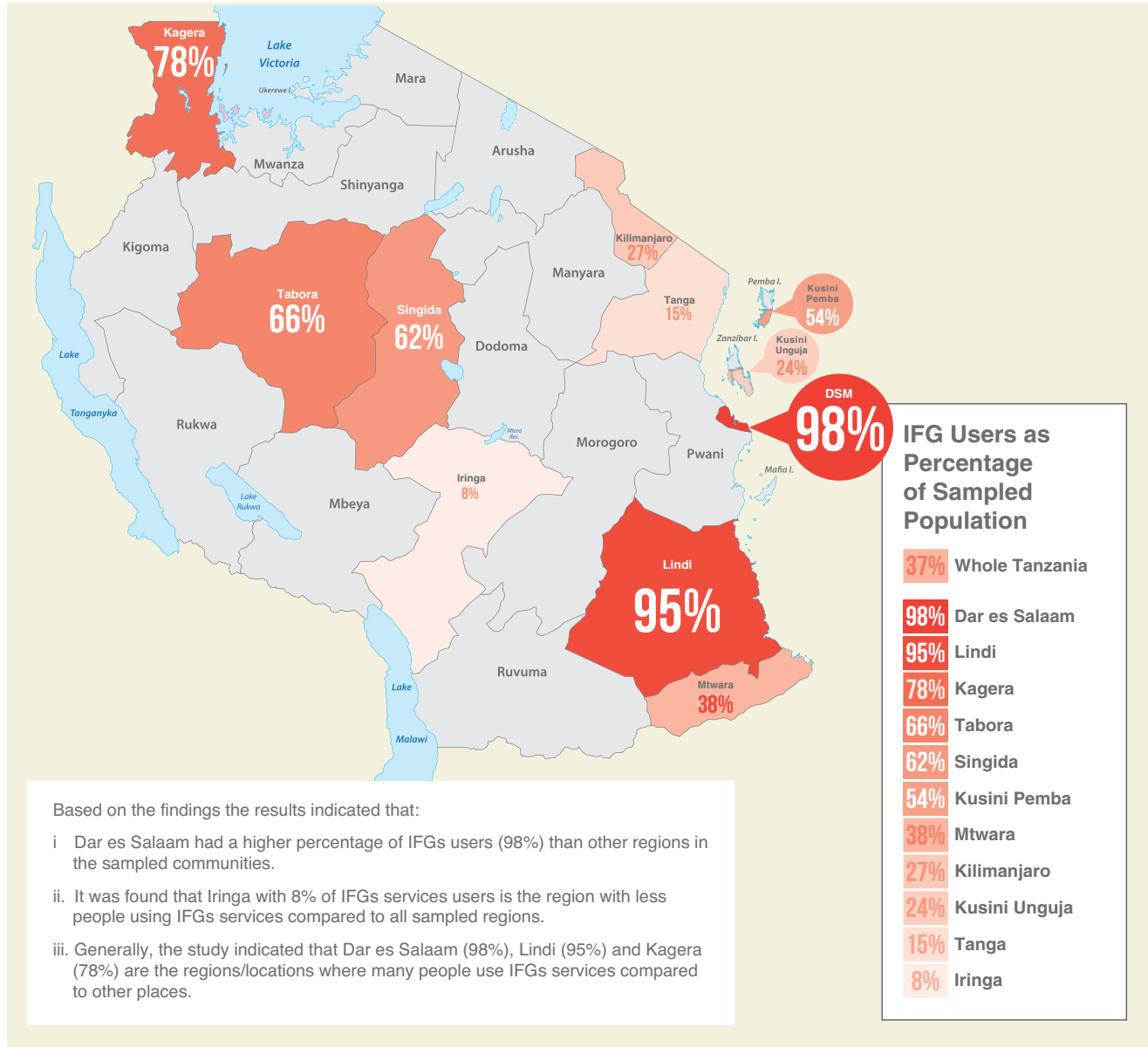


### Total number Institutions attended by IFGs



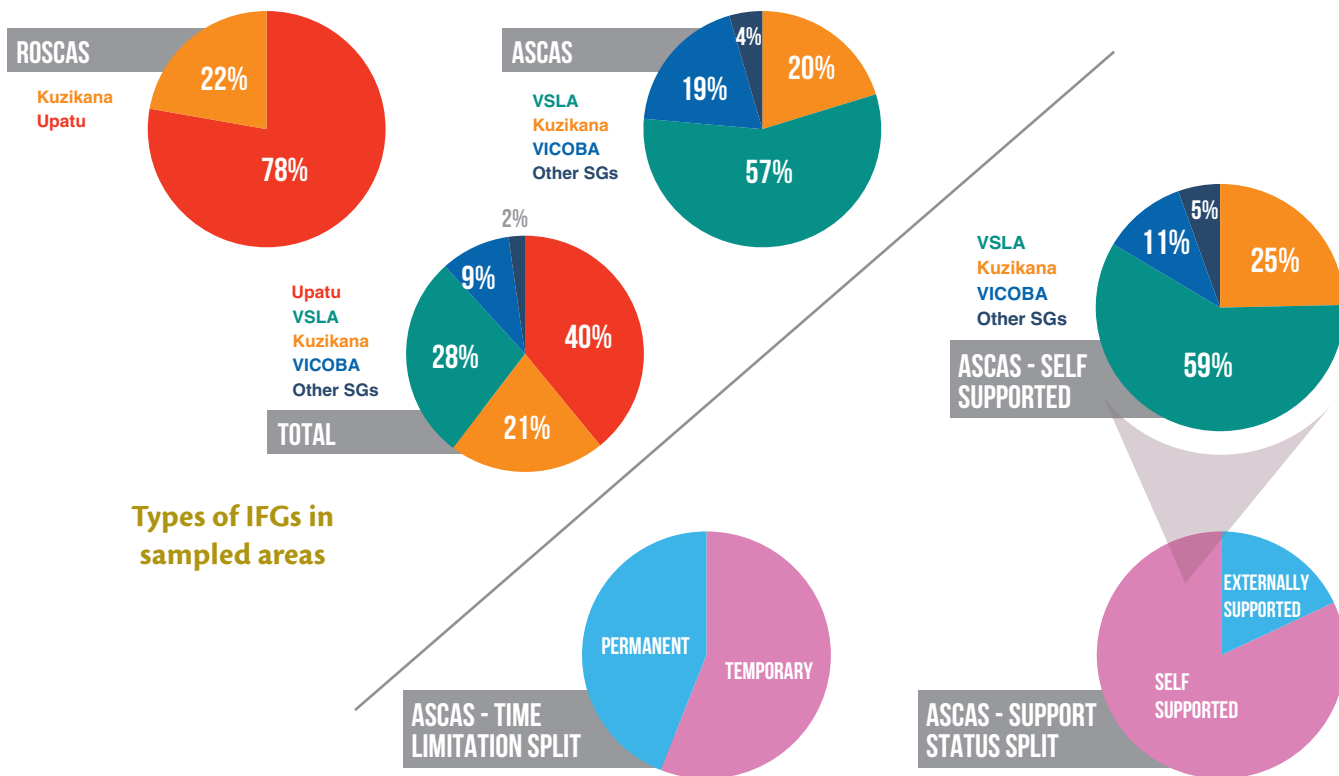
The largest group type in terms of membership by a wide margin is the kuzikana (funeral society). While there are a relatively small number of these groups, they were present—like upatus—in every community sampled, and many of them have hundreds of members.

### IFG sampled communities

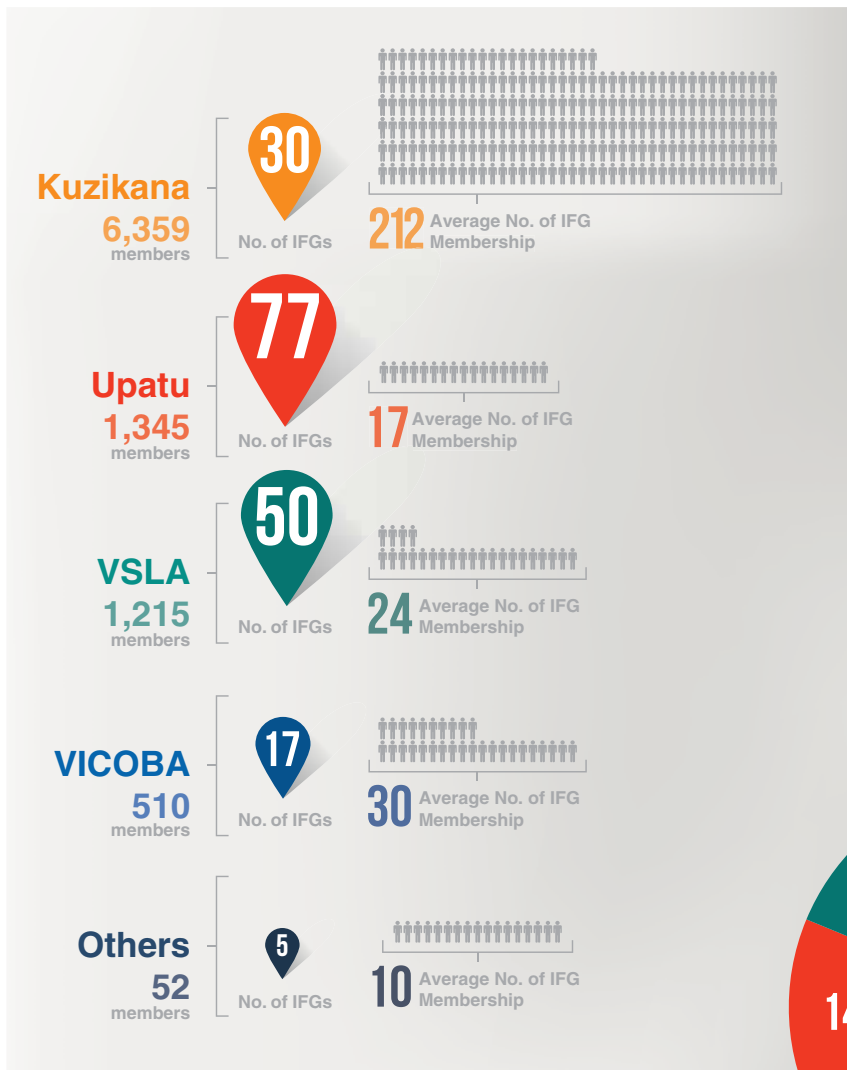


Some large kuzikanas test the boundaries of formality. The head of every household is expected to participate in the funeral societies in some sampled villages, including Ishinsi (Singida) and Nyakatoke (Kagera). While such societies are clearly more formal than a small ROSCA in an outlying quadrant of the same village, they remain private sector initiatives (albeit with considerable support from local social norms), outside of the control of either government or any other formal sector institution.

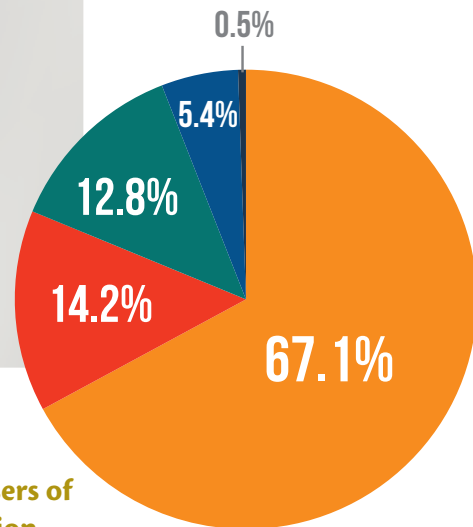
- Members typically receive smaller loans when the purpose is unplanned than when the purpose is planned.
- IFGs are unable to supply coverage for large insurance events, like flooding property destruction or widespread crop failure. Death events also need extra cash to cover within IFGs, suggesting an unmet demand.
- Members of IFGs with savings view the option to borrow as valuable form of insurance, even if this is not exercised.
- While many IFG members had mobile banking enabled, few were using them. Unlike mobile banking, IFGs allow members to borrow, has no fees, and there is no risk of inability to recover funds sent to incorrect recipients.



**Classification of ASCAs in sampled areas**



Number of members by IFG type



Percentage of IFG users of sampled population





## 5. OPPORTUNITIES AND CHALLENGES

The research shows that a Tanzanian in most communities today can join not just a funeral society but several upatus and probably one or more varieties of engineered ASCAs as well. Not only that, the increase in the scope and complexity of community IFG sectors is such that many IFG leaders across the country today have much deeper experience than IFG leaders in their parents or grandparents generation. All of this has resulted in an increase in financial inclusion in Tanzania, in line with an expansion in the capacity of IFGs to meet demand—even while risk has increased with added complexity.

There are three main areas that pose a challenge for IFGs given their growth, scale, dynamism, and complexity:

- Skills gap
- Standardization
- Innovation

### **SKILLS GAP NEEDS TO BE OVERCOME**

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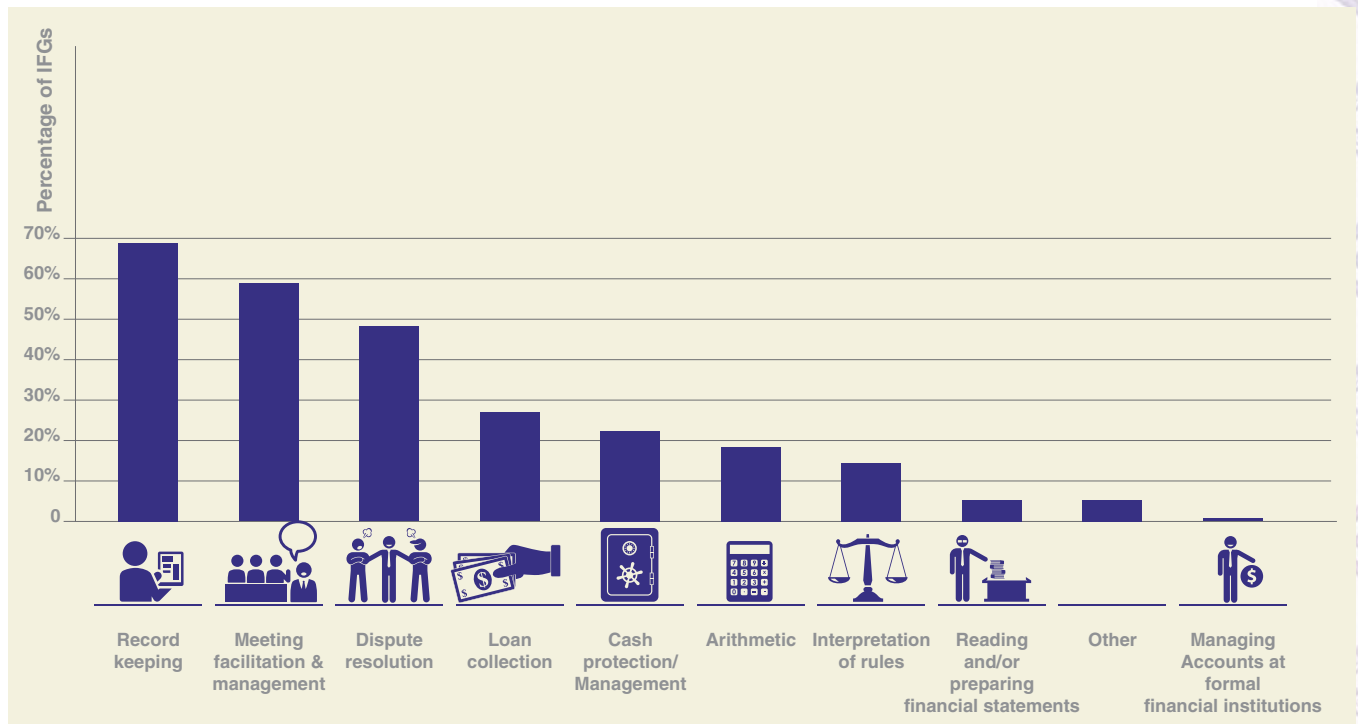
Record-keeping, meeting management and dispute resolution are the “big 3” issues areas in which leaders of groups, and key local informants, viewed IFGs as requiring additional skills. It is telling that these issues were clearly viewed as more important than either loan collections or cash management.

Poor record-keeping afflicts every type of group, from upatus that maintain internal accounts, to funeral societies, VICOBAAs, and VSLAs. Key informants in several villages with exposure to the whole local IFG sector flagged it a critical issue across their local sector. Poor record-keeping affects calculation and attribution of interest, dividend and capital pay-outs, and areas on the boundaries between arithmetic and book-keeping. For example:

- The choice between flat and declining balance.
- The compounding of unpaid interest.
- Attribution of payments to interest before principal.

A major issue for engineered ASCAs is calculating distributions. For example, one independent VA in Bungu, Zanzibar, went up to class 7 in Tabora where, he claims, “education is a little better than here (Zanzibar).” He does all the distributions, by invitation from the groups, and receives TSh10,000–20,000 for each. The groups cannot integrate the parts of the calculations together, nor do the division.

### Level of skills needed by IFGs



## THERE IS ROOM FOR INNOVATION AND ENGINEERING

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There is much scope for continued innovation in Tanzania, among IFG-incubating NGOs, donors, and government.

However, there are already many IFGs in communities all over the country, and it is no longer the case that the only effective way of contributing to financial inclusion through IFGs is to develop new and better models for mass distribution. There are many other options, from developing better IFG technologies and encouraging their transmission through existing IFGs, to supporting local and national networking in the natural IFG sector, to investing in the development of technical support and national practice standards across the IFG sector as a whole.

IFG engineering is being mainstreamed into government programming. For example, the Tanzanian Social Action Fund (TASAF) III is a productive social safety net based on cash transfers and targeting millions of Tanzanians living beneath the basic needs poverty line. One component of the program involves linkage of cash transfer recipients to savings groups. Such transfers are fraught with governance risks. However, such programs present opportunities for creative IFG-engineering, in which a more effective balance is struck between member capabilities, transactional governance processes and the requirements of the cash transfer program.

A recent study of insurance in Tanzania by Cenfri and Finmark Trust found that 1.9 per cent of the population, or about 400,000 people, have access to informal insurance, primarily health-related. They classify over 15 million

Tanzanian adults (about 72 per cent) as hard to reach and observe that large aggregators like banks, employers and mobile networks will not be able to reach most of them. “Rather, insurers will have to find specific well-capacitated smaller aggregators.”



## 6. CONCLUSIONS AND RECOMMENDATIONS

IFGs are delivering financial services to millions of Tanzanian households. In Tanzanian communities today, whether in urban or in remote rural areas, there are many IFGs: including upatus, kuzikanas, VICOBAs, VSLAs, and other varieties and hybrids.

The deepening cash economy challenges IFGs to continue supplying more services, better, and with more features. This pressure can push practices too far ahead of capabilities. Meanwhile IFG entrepreneurs face serious day-to-day operational problems, including record-keeping, meeting facilitation and management, and dispute resolution. Perhaps surprisingly, the problems of loan collection and cash management are viewed as less serious.

If in Tanzania informal finance delivered through groups is seen as a form of financial inclusion—and a bridge to more formal financial inclusion—then a shift need to take place from propagating models to building a more integrated industry.





## RECOMMENDATIONS:

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- Expansion in the number of IFGs in Tanzania should be supported and encouraged.
- Invest in research and ASCA engineering.
- Conduct a quantitative analysis of the scale and scope of participation by IFGs in Tanzanian financial markets in order to better guide IFGs.
- Build a national IFG industry.
- Invest in development of engineered ASCA networks at the local level for funeral societies, VSLAs, and VICOBAs to enhance sustainability.
- Support the development of an association capable of representing a wide and diverse range of promoters and practitioners within the funded IFG sub-sector.
- Support moves to enable IFG to be able to open a basic deposit account.
- Registration of IFGs should not be compulsory depending on types.





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