RESEARCH INSIGHTS

Can Savings Groups Foster Access to Formal Financial Services?

- **Savings groups provide access to financial services to households who are underserved by formal financial institutions and microfinance lenders.**
- **Access to this model in rural Peru reduced vulnerability to idiosyncratic shocks and led to greater investments in housing quality and specialization in agricultural activities, especially in poorer villages.**
- **Savings groups reduced access to formal loans and increased reliance on microfinance loans, which goes against the graduation hypothesis. The negative effect on access to formal loans is driven by villages with higher poverty levels and lower pre-treatment access to formal credit.**

CONTEXT

Most of the rural poor around the world remain excluded from the financial system, often meeting their needs for financial services by relying on informal mechanisms that are frequently linked to social networks. A popular informal mechanism in the developing world is Village Saving and Loan Associations (VSLAs), also known as savings groups or self-help groups. Besides directly providing access to credit and savings, VSLAs provide their members with the skills to navigate the financial system and foster good financial habits. Thus, VSLAs may also contribute to borrowers' progression up the lending ladder and graduation into access to formal credit.

PROJECT

We evaluate the effectiveness of VSLAs in improving households' well-being and test if the model facilitates graduation into the formal financial system. Relying on a clustered randomized control trial, we evaluate the impact of the introduction of savings groups on poverty, vulnerability, and access to credit from other lenders. The treatment was randomized at the village level and consisted of the promotion of savings group in 240 villages in rural Peru between 2014 and 2016. While previous studies have studied the effect of VSLAs on poverty, wealth, and resilience, the focus on deeper financial inclusion levels is new.

RESULTS

Administrative records on the operations of the savings groups show that members are able to save by making monthly deposits, while rarely withdrawing from their balances. In turn, they rely on loans from the group to finance their needs, which is consistent with a high valuation of precautionary savings motives.

Two years after the introduction of savings groups, treated households exhibit a significant reduction of exposure to idiosyncratic shocks. This effect is particularly strong in poorer villages, where we find important declines in exposure to hunger, death, and job loss shocks. The treatment also led to average improvements in housing quality, which is directly connected to better health outcomes. While the treatment had no effects on average income or expenditures, treated households show a significant drop in health expenditures, particularly in the case of poorer households. The treatment also led to increased specialization in agricultural activities among poorer households, which may be explained by their reduced exposure to idiosyncratic risks.

Credit bureau records show that treated households in poorer villages are less likely to hold debt from formal lenders. On the contrary, treated households in richer villages show almost null effects in their access to formal lenders, but an increased likelihood to borrow from microfinance lenders. The reduction in the probability of borrowing from formal lenders is mostly driven by households in villages with low pre-treatment access to formal credit. Savings groups respond to the need to save by offering means to do so collectively, and they also offer access to small loans, but at relatively high interest rates. Nevertheless, this supply of credit is hassle-free, and the cost of credit is partially returned to the member through dividends paid out on savings.

Key Concept

VSLAs

Self-managed groups of 10-30 people who save in a common pool and lend from it to members who request funding. Interest paid on loans is proportionally shared according to members' savings levels.

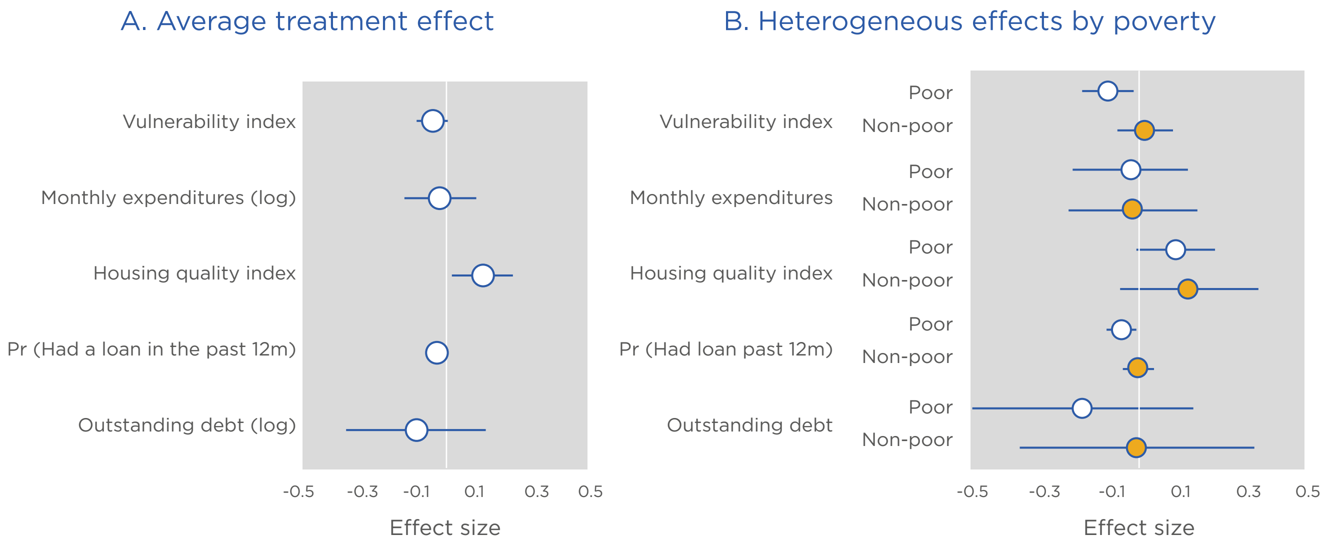
POLICY IMPLICATIONS

The rural poor often must resort to (and many times prefer) informal mechanisms to handle their financial needs, including crop diversification, borrowing from friends and neighbors, and saving cash at home, among other options. Village banks and savings groups are probably the most popular group-based methodologies promoting financial inclusion among the rural poor. While both village banks and savings groups are based on peer support and pressure, the latter have a more salient focus on savings-based services.

While we show that access to VSLAs has promising impacts on households' vulnerability, well-being, and diversification strategies after two years of exposure, a key question that arises is the sustainability of these effects over time. On one hand, the emergence of savings groups was not spontaneous, even though they do not require external funding to be created. Thus, once the sponsor institution moves to other areas, groups face a reduced chance of survival. On the other hand, even if the group survives without further support or guidance, other threats emerge related to the capacity of the group to keep rotation rates stable, maintain group heterogeneity, and mobilize funds.

However, access to VSLAs may be an important steppingstone in terms of deeper financial inclusion levels, particularly for households previously excluded from the financial system. Given our results, a key policy question would be whether these groups could serve as a platform to reach the rural poor with additional complementary support to bring them above the poverty line and improve their connection to the formal financial system. If good repayment records and a savings balances kept in the group become observable to other lenders, group members could rely on their (often newly created) credit histories to secure access to formal loans.

Figure 1. Effect of VSLAs on Household Well-Being and Access to Credit from Other Lenders



Note: Round markers show the average treatment effect, and lines reflect 95% confidence intervals. Panel A presents average treatment effects, while panel B presents heterogeneous effects by the village's poverty level.

FULL STUDY

Frisancho, V., and M. Valdivia. 2020. "*Savings Groups Reduce Vulnerability, but Have Mixed Effects on Financial Inclusion*."

DEPARTMENT OF RESEARCH AND CHIEF ECONOMIST

The Department of Research and Chief Economist generates new ideas to enrich the knowledge base that supports the policy agenda of the Inter-American Development Bank (IDB) and its member countries for achieving sustainable and equitable development in the region. To maximize the impact of its research, the Research Department carries out activities that serve as inputs to other IDB departments, governments, the academic community and public opinion in the region.

Research Insights #50: October 2021 www.iadb.org/res

IDB