What Makes SCAs Work?

As described in Chapter 9, every financial system must meet the conditions of the **Financial Systems Design Principle** in order to work properly.

Financial Systems Design Principle:
In order to be successful, a financial system must maintain all of the following features: 1. Trust 2. Discipline 3. Financial Sustainability 4. Leadership, Management, and Governance 5. Transparency 6. Fit the Target Population

Churches and missionaries are usually unable to meet these conditions in the Provider Model, while in the Partnership Model they rely on a sound MFI do so. How are these conditions met in the Promotion Model? The answer to this question comes down to how well the savings and credit association (SCA) performs, for the financial system is in the SCA, not in the church or missionary that promotes the SCA. This paper briefly considers how a SCA is able to satisfy the six conditions in the **Financial Systems Design Principle**.

Design Principle #1: Trust is the Foundation of Microfinance

At the individual level, SCAs build trust in the group members' 3 Cs in ways that are similar to the Grameen Bank's group-based lending methodology. Because the money that is being lent by a SCA comes from the members themselves, people have a strong incentive to form a SCA only with other people whom they believe have high *character* and *capacity* to repay, i.e. the first two Cs.

SCAs address the third C, *collateral*, in several ways. First, SCAs sometimes require people to buy shares or to save before borrowing, both of which would be forfeited in the case of defaulting on a loan. In addition, the members have a strong incentive to use social pressure to enforce repayment, substituting social collateral for physical collateral. Finally, SCA members might even repay loans on behalf of a delinquent borrower in order to make sure that the system does not collapse, for if it collapses they could lose all of the money they have saved in the group.

At the level of the financial system, trust that the SCA will endure into the future is built when members observe the SCA functioning well over time. When participants see the officers and other group members repeatedly and faithfully following the rules of the SCA in such a way that their money is protected, it helps them to trust the system will endure. One of the strengths of SCAs is that the members have fairly strong incentives to make the system work well, for their own money is at stake.

While SCAs have the potential for strong trust at both the individual and system level, it is neither easy nor automatic to build and sustain such trust. Indeed, many people in the Global South report that they have been members of SCAs that failed, which can make them somewhat leery of joining a SCA started by a church or missionary using the Promotion Model.

Design Principle #2: Discipline

At the individual level, discipline means that the SCA members must faithfully make their savings contributions, repay their loans, and attend group meetings. At the systems level, discipline means that the SCA must follow its rules and must hold members accountable to keeping their commitments. Because the money in the SCA is from the members' themselves and because they operate the SCA, they have a strong incentive to work hard to make sure that the SCA follow its rules and to hold one another accountable for keeping their promises.

Design Principle #3: Financial Sustainability

SCAs do not cost much to operate. In addition, most of the costs that do exist--selecting and monitoring borrowers, faithfully recording savings and loan transactions, protecting accumulated funds, and repaying people's savings—are implicitly born by the group members themselves. In essence, the members volunteer their time to carry out these activities in the process of forming the group, participating in the regular group meetings, and occasionally in making visits to the homes of delinquent loan repayers. But unlike most volunteers, the SCA members have a strong incentive to keep volunteering because their own money is at risk.

In addition, it is imperative that SCAs keep the "financial pot" in Figure 9.1 full, by ensuring that cash inflows exceed outflows, which they have every incentive to do, for if the pot is going dry, members will lose trust and will stop repaying their loans, which will cause the savers in the SCA to lose their money.

Design Principle #4: Leadership, Management, and Governance

The SCA's *leadership* must be trained to understand and execute their roles properly. In addition, all of the members need to be trained in how the SCA functions, for as they shape the group's policies, elect the leadership, decide who will get loans, monitor repayment, return people's savings, etc., these members are the financial system's *management* and *governance*! But unlike most financial systems, the *management* and *governance* of a SCA are not lending other people's money, they are lending their own money, which reduces the risk of bad practices as long as the operations are simple enough for them to understand.

Design Principle #5: Transparency

Transparency is one of the key ways that trust is built and maintained in a financial system. Members of SCAs have a strong incentive to ensure that all of the SCA's activities—financial transactions, loan allocations, record-keeping, and storing money--are conducted in the open, because they want to reduce the chances of fraud with *their* money.

Design Principle #6: Fit the Target Population

As discussed in Chapter 4, the "microcredit-for-microenterprises" approach to microfinance emphasizes providing loans for business purposes. But as summarized in the **Microfinance for Households Principle**, business investment is only one of the five categories for which poor families need *convenient, flexible, and reliable* financial services.

<u>Microfinance for Households Principle:</u>
Poor households lack convenient, flexible, and reliable financial services for:

1. Consumption Smoothing
2. Business Investments
3. Household Investments
4. Lifecycle Needs
5. Emergencies

Moreover, within these five categories there are enormous variations in the types of financial products that people desire based on their income, wealth, occupation, age, gender, marital status, religion, and culture.

And this is where SCAs really shine. Because the members determine the SCA's policies, they can use their knowledge of one another and of local conditions to tailor the SCA's savings and loan services to meet the particular needs of the group. And once again, because it is their money, the members have every incentive to try to serve their "customers," i.e. the other group members, well. For example, a SCA comprised of very poor people might decide that each person will save only $0.05 per week, while one with people who are better off might decide that each person will save $5.00 per week. Similarly, decisions about loan sizes, interest rates, and repayment periods can be attuned to the particular needs and capacities of the members. And the flexibility extends to uses of the lump sums as well. While MFIs have traditionally focused solely on loans for business purposes, SCAs can allow their members to both save and borrow for all of the five categories of the lump sum needs described in the **Microfinance for Households Principle**.