IOSR Journal Of Humanities And Social Science (IOSR-JHSS)
Volume 20, Issue 8, Ver. IV (Aug 2015), PP 95-98
e-ISSN: 2279-0837, p-ISSN: 2279-0845.
www.iosrjournals.org

The Rotating Savings and Credit Associations (ROSCAs): Unregistered Sources 0f Credit in Local Communities

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Abstract: *The rotating savings and credit association (ROSCA) has been shown, in the extensive literature, to exist in developing countries in both rural and urban areas, among both females and males. This paper intends to provide a critical reflection on the use of ROSCAs in reducing poverty in local communities. It describes the different forms of informal and microfinance institutions, discusses the household poverty measure and, reviews the relationship between ROSCAs and poverty reduction. The paper argues that ROSCAs are likely to make a difference tolocal communities' welfare, measured as a change in the household consumption.*
Keywords:*Informal financial institutions, local community, poverty, rotating savings and credit associations*

I. Introduction

In Africa and elsewhere, there is a long-standing tradition of community members forming groups to help each other in times of difficulties. One of such self-help initiatives is the Rotating Savings and Credit Association (ROSCA) [1]. ROSCAs are community-based financial initiatives in which self-selected members of a group regularly (usually every week) contribute an equal amount of savings toward a common fund [2].

The collected fund is disturbed to an individual member who is queued to get the contribution, and the disbursement rotates among members until every member has received the pooled fund [3]. The author points out that ROSCAs were found to be relatively inclusive, particularly when compared with more formal credit schemes, often including the most marginalized and vulnerable socio-economic categories.

The ROSCA supporters believe that group-based savings and loans programs are the best alternatives for poor in rural areas due to their ability to reach a massive scale, their cost effectiveness, and their high-level of efficiency [1]. Savings deposited can give members access to a much-needed financial safety net against minor illnesses, smooth consumption, or pay their children's education expenses, and be used to start up or expand micro businesses [4]. The history of ROSCA existed before the introduction of money in the economy where the barter system existed; people of village formed ROSCA by making periodical contribution of grain such as wheat, rice, corn, and other paddy [5].

Yusuf et al. [6] find that the informal financial institution plays an important role in reducing poverty among the members. The authors view ROSCAsas a method of mobilizing funds that not only provides a means by which members have access to funds, but also provides an avenue by which they can have access to inputs and technology contributing to productivity growth.

Getting access to a useful lump sum through building mutual savings is central to informal group finance schemes. In ROSCAs, the equal periodic savings of every member are pooled and given to each member in turn: there are therefore as many poolings as there are members and the cycle ends when each member has taken her prize [7].ROSCAs can be seen as a form of cheap financial intermediation, turning small amounts of weekly savings into a few larger loans [8].

Woolsey [9] notes that ROSCAs are important in many developing countries in Africa, South America, and Asia, and have common circumstances or attributes: (1) a communally-based social order, (2) obligations that are held to be collective in nature, (3) social and economic stability, (4) social and economic isolation, and (5) similarity among ROSCA members in social status. The author further states that the actors in this world, especially poor ones with little or no access to banks or other regulated financial institutions, come to see ROSCAs as a natural and efficacious strategy for capital accumulation and lending purposes..

ROSCAs occur in Asia, Africa, and South America, and they often go by local names: Tontines in West Africa, Hui in China, Muzikis or Likelambas in Democratic Republic of the Congo, Ekub in Ethiopia,Stokvel in South Africa, Mukando in Zimbabwe,Isusu in Nigeria, Susu in Ghana, Tandas in Mexico, and Chits or Kuries in India [10].The Author asserts that, given the lack of external regulation and the incentive for ROSCA members not to stop contributing after their turn to collect, it is remarkable how low the default rate is among ROSCAs worldwide.

Salahuddin and Rashmi [11] describe three main causes for existence of informal sector in the economy. Firstly, drawbacks of formal financial sectors due to which a large population is financially excluded from the formal financial sectors and for such group of people informal finance is an important source for enjoying the financial services. Secondly, difficulties in obtaining the institutional credit, documentation, terms and condition, and collateral for people. Thirdly, poor functioning of the formal sectors in developing countries, and India is also a country where informal financial practices are found among households, small-scale enterprises in rural, semi-urban and urban part of the country.

Saving as a group

There are many ways to save in a group [12]. The Rotating Savings and Credit Association (ROSCA) method is the simplest form; it does not require record keeping. It also usually serves a smaller group (8 to 15 members), although larger ROSCAs do exist. A ROSCA is commonly described simply as an informal association of participants who make regular contributions to a common fund, which is given in whole or in part to each contributor in turn. The Accumulated Savings and Credit Associations (ASCAs) offer flexible savings and credit options to its members, but require more record keeping than ROSCAs. Credit Unions offer the widest range of services to their members and therefore require an even more complex record system [13].

Accumulating Savings and Credit Associations (ASCAs)

The ASCA method is a more flexible form of savings group, but it is also a bit more complicated. In an ASCA, the contributions collected at each meeting are accumulated, rather than redistributed at the end of each meeting like in a ROSCA. With this accumulating fund, the group can do many things. It can lend to its members free of interest or with interest. Interest earned on loans can become income earned for savers, adding incentive for members to keep their savings with the group. This method can serve both savings and credit needs in a flexible way [5]

Beck [14] defines ASCAs as a savings-based microfinance instrument fit for the African context. They (ASCAs) provide an opportunity to join a group of people that trust each other, accumulate savings together, share experiences, and take small flexible loans from the group's funds for investment, consumption, or emergencies. The author, in his study, finds a positive influence of ASCA participation on income and on the funds available to the household leading to greater spending and ownership of household assets.

Credit Union or Cooperative

A credit union operates like an ASCA but serves a much larger membership (from a low of 100 to several thousands) and offers a wider range of savings and credit services to its members. Credit unions are usually chartered under a cooperative or credit union law of the respective country. Their status must be approved by the agency that regulates credit unions in order to be operational. Credit union funds are also normally kept in a bank for safekeeping [15]. The authors claim that credit cooperatives become village banks that require bookkeeping and complex management.

Microfinance: The Vicious cycle of indebtedness

Hickel [16] points out that microfinance usually ends up making poverty worse as microfinance loans are used to fund consumption by helping people buy the necessities they need to survive. In South Africa, for example, consumption accounts for 94 per cent of microfinance use. As a result, borrowers do not generate any new income that they can use to repay their loans so they end up taking out new loans to repay the old ones, wrapping themselves in layers of debt. The author argues that when micro-loans are used to fund new businesses, budding entrepreneurs tend to encounter a lack of consumer demand. The worst and much more likely is that the new businesses fail, which then leads, once again, to vicious cycle of indebtedness that drives borrowers even further into poverty.

Fanta [1]reinforced the skeptics' idea that microfinance services have been skewed to urban areas and away from the rural poor due to high transaction costs and low loan values with interest too low to be profitable. The majority of rural poor are not the entrepreneurial base that they are made out to be. Loans are largely not investments, but rather used to smooth consumption. The lack of basic needs could even lead to excessive debt burden and worsen the overall situation of the rural poor.

Bateman [17] argues that countries should not abolish microfinance altogether, but simply that microfinance will never work until the background conditions that produce poverty in the first place be addressed. Setting up the right systems for small businesses to succeed, such as strong subsidies, state assistance and welfare support to prop up entrepreneurs when they fail is a considerable solution [16]. Microfinance is not a magic sky-hook that reaches down to pluck the poor out of poverty. However, it can be a vital platform that the poor can use to raise their own prospects [18]

Hanlon, Barrientos and Hulme [19] suggest that direct cash transfers, with no strings attached, not only deliver success where microfinance fails; they appear to be the single most impactful anti-poverty intervention. Experiments with basic income grants have been conducted in Namibia, Mexico, South Africa, Indonesia and elsewhere, all with astonishingly good results, as they smooth out consumption deficits and allow people to start small businesses by taking advantage of increased local demand.

The household poverty measure

Measuring the household poverty based on consumption or income has a long tradition, although consumption is usually the preferred indicator [20]. The report discusses that consumption is typically assumed to be less volatile than income and is thus often seen as a better measure of current living standards. This paper considers incremental changes in people's consumption as a measure of their welfare.The United Nations Development Programme in 2010 adopted the multidimensional poverty index (MPI) as a poverty measure to show not only who was poor but also in what ways [21]. The author notes that the MPI uses data for each household and creates a profile of the deprivations being experienced, looking across health, education, and living standards.

ROSCAs and poverty reduction

Ndjeunga[2] finds that the poor members in Cameroon benefit relatively more from participating in ROSCAs than wealthy members. Rangarirai and Gwangwava [22] find a strong relationship between ROSCA membership and operations sustainability. The authors observe that investment ROSCAs are found to be prevalent in Chinhoyi as compared to other types where most thriving small businesses are in the retail sector.

The existence of ROSCA in Nigeria has brought a relief to the people because it is easy access to funds and convenience [23]. The author concludes that ROSCA has demonstrated that informal finance remains very relevant in enhancing income of the poor household and for community development in the developing world.

The social capital is important to poor households. ROSCA is one of the community support mechanisms in Viet Nam helping fragile households cope with certain crises through the network of informal and formal relationships [24]. Lasagni and Lollo [25] find that the endowment of social capital at the village level correlates positively with individual ROSCA participation in Indonesia.

II. Conclusion

Poverty in the developing world has been seen as a rural problem. Microfinance institutions cannot be effective in reducing poverty among the rural poor unless the conditions or circumstances of their poverty are identified and addressed. Although ROSCAs are likely to improve the participants' welfare in local communities, each individual well-being may be contingent to their pattern consumption expenditures. Given the social and economic status of the poor people,national basic income grants policy should be one of the most impactful anti-poverty interventions.The future research should look at the ROSCA members' behavior in order to minimize the moral hazard issue among the poor, and to how ROSCAs can bring together people across different communities.

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