Forging Links between the Formal & Informal Financial Sectors

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Preface
1. Introduction

How do we develop linkages between banks and the assorted informal financial service providers in order to promote banking among large segments of the population who banks are unable, or unwilling to serve? Many developing countries are looking for answers to this question because their financial systems are not very deep and as a result not fully contributing to economic growth. Forging linkages have implications for the mobilization of local savings and their efficient use as well as for the macroeconomy. Linkages would enhance the flow of savings and credit up and down the system. Ghana can grow faster if savings of small contributors gathered through the informal sector operators can be re-directed to other productive areas of the economy through the banking channels. Linkages have the potential to make saving safer and more profitable for individual clients, as well as give the formal sector access to a significant, low cost of loanable funds. Equally important, linkages can lower transaction costs and overcome information barriers that impede rural financial intermediation. It can also help establish the transmission channels through which credit control and monetary policies targeted at the formal sector can have economy-wide effects.

The Center for Policy Analysis (CEPA) commissioned this study with the objective to document emerging strategies in forging links in Ghana’s financial sector and to suggest measures that may be adopted to facilitate the process. The study is part of CEPA’s work program on financial sector developments in Ghana, particularly its role in

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macroeconomic management. It complements an earlier study reported in CEPA’s *Macroeconomic Review and Outlook, 1999*. CEPA’s efforts in this direction is guided by the belief that effective policymaking demands thorough understanding of on-going practices. Periodic reviews and assessments of local practices are needed for two reasons: they are useful starting points in the search of new course of public policy, and they help to determine what public policy might realistically and reasonably expect to do in the development of the financial system. This study is a contribution to both ends.

Formal and informal financial sector activities exist side-by-side in many developing countries. Formal intermediation, rooted in Western European banking traditions, is commonly associated with banks whose operations are governed by government regulation and supervision. In Ghana this includes commercial banks, development banks, investment banks and insurance companies. The informal financial sector, largely of indigenous origins, is commonly associated with the assorted institutions of finance that operate outside the scope of conventional banking and government regulation. In Ghana this sector includes variations of rotating savings systems, professional moneylenders, part-time moneylenders, traders and suppliers credit, mutual fund groups, mobile susu collectors, credit unions and cooperatives.¹

Not too long ago the activities of informal financial service providers seemed too remote and irrelevant to many experts. But perceptions are changing quickly. Many researchers are asking whether the practices of informal sector lenders, susu operators, workplace and community savings clubs and other indigenous practices based on trust, social network and norms can overcome the difficulties behind formal banking practices. There is therefore a growing interest in understanding informal financial institutions and their mechanisms. Recently the motivation has also come from the observation that financial sector reforms designed to overcome the problems of the formal banking sector and to

transform the financial system of reforming economies, many in sub-Saharan Africa, have yielded mixed results. In Ghana, it is well known that financial sector reforms have not halted the growth of informal financial sector practices. In fact, the evidence is to the contrary. Studies by Aryeetey conducted in 1994 and Bortei-Doku and Aryeetey in 1996 suggest that susu remains a resilient institution of savings mobilization and credit. Informal finance is not simply a component of the informal economy, nor is it confined to only rural communities, the least educated, and the lowest income earners. Despite the establishment of new banks, increased autonomy of the commercial banks and interest rate liberalization, informal sector finance is the first choice of traders, artisans, farmers and small enterprises in both rural and semi-urban areas and even among salaried workers in the urban areas.

A rich body of knowledge exist to explain why this is so. Informal financial activities play an important role in solving savings mobilization and credit allocation problems for those who otherwise may have no access to formal sector banks, or those whose needs may not be effectively handled by the banks. The limited number of bank branches in several regions, the limited banking hours, and the literacy level that formal banking requires all discourage demand for banking services. Recently, the introduction of minimum deposit balance, the orientation to corporate and institutional banking, and the redirection of credit away from small, non-salaried clients to salaried clients by the major commercial banks have further limited access to banking for a large segment of the population. The result is an even greater demand for the services of informal financial sector providers, relying on what is closest and most conveniently available to them.

The problems of the formal sector in the mobilization of savings and allocation of credit, both essential activities to spur economic growth and development, are well known. Poor performance is commonly attributed to financially repressive policies by government,


including, high reserve requirements, interest rate ceilings, control on credit allocation, and perceptions that a large segment of rural population are not ‘bankable’. Increasingly, there are attempts to look for possible solutions to these underlying difficulties. Financial sector reforms initiated in reforming economies were aimed at reducing government intervention in financial markets, enabling more efficient institutions to emerge, and improving the regulatory environment and the information infrastructure. It is also in the search for solutions that researchers and policymakers are increasingly paying attention to the role of the informal financial sector and calling for closer links between the informal and formal/semi-formal financial sectors.\(^3\)

It is well-known that use of informal finance is not confined to only rural communities. Informal finance is also the first choice of traders, artisans, farmers and small enterprises in both rural and semi-urban areas and even among salaried workers in the urban areas. A rich body of knowledge has emerged to explain why this is so. Informal financial activities play an important role in solving savings mobilization and credit allocation problems for those who otherwise may have no access to formal sector banks, or those whose needs may not be effectively handled by the banks. Informal markets are characterized by flexibility of operation, and by the use of social networks and market inter-linkages to overcome many of the problems that hinder lending activities of the formal banks.

For policy makers the essential questions are these. If the formal financial sector is limited in its capacity to promote economy-wide services because of institutional and structural problems, and if the informal sector services are useful and essential, yet limited in scope, then by what means can the comparative advantages of both the banks and the informal sector operators be harnessed to enhance the development of the financial system? Should moneylenders be strengthened in their capacity as suppliers on the informal financial market? Should they be permitted to operate as agents of banks? Should susu operators be assisted in mobilization and administration of deposits and in the granting of credit? And if these are desirable, how can they best be done?

\(^3\) (Germidis, 1990).
Forging links, therefore, should help improve domestic resource mobilization and credit allocation. Closer linkages will improve the efficiency of the financial system by enhancing the flow of savings and credit up and down the system. Savings in other sectors can be re-directed to other productive areas of the economy. Equally important, linkages can lower transaction costs and overcome information barriers that impede rural financial intermediation. Closer linkages would also help establish the transmission channels through which credit control and monetary policies targeted at the formal sector can have economy-wide effects. An expansion of credit in the formal sector will induce a corresponding expansion in the informal sector and vice versa for a contraction. The stronger the linkages, the more predictable the impact of monetary policies on economic activity.

While support and relevance of the need to forge linkages is widely acknowledged\(^4\), how to develop appropriate linkages between institutions remains a challenge for both policy advocates and policy-makers. In Ghana, it has been known that considerable change has been underway since the late 1980s, even if some of the attempts have not always yielded successful results for the financial sector as a whole. Studies have shown that (a) inter-linkages exist in the form of money-lenders using bank credit to finance their own activities or for on-lending; (b) susu operators also deposit their mobilized funds in commercial banks; (c) linkages on the saving side appeared stronger than on the lending side; (d) linkages in lending were both complementary and competitive; (e) linkages were also for the most part spontaneous linkages that had developed in the normal course of business transactions; and (f) the potential to forge links was undermined by mutual distrust and fear of competition, and (g) overall, the linkages that existed in the late 1980s were not significant enough to overcome the difficulties in savings mobilization and lending\(^5\).

\(^4\) (See World Bank Review, 1994)

In the absence of specific strategies for integrating financial markets, and for the fact that strategies thought to have been successful elsewhere are not replicated easily or transplanted elsewhere, many share the view that successful strategies for linkages must evolve within the economy itself. Workable strategies must build on the network and norms, social infrastructure, and the nature of economic activities in each location. The survey, of which the results are reported here, looked at the potential for linkages, the expectations of the commercial and development banks, the rural banks, the savings and loan association and susu operators, their perceptions of emerging practices – what works and what does not. The survey, conducted during the month of July 2000, covered 4 different financial sector agents: the commercial and development banks, the rural banks, savings and loan companies (S&L’s), and finally susu companies and agents. It was implemented in 6 regions- Greater Accra, Eastern, Ashanti, Brong Ahafo, Western and Central (out of the 10 regions)6.

2. Survey Results

Appendix 1 presents a summary of the survey results. The data are percentage of respondents – commercial and development banks, rural banks, and savings and loans (S&L’s) –who either gave first-placed ranking to an option for each question or responded yes/no depending on the question type. For example, 84% of respondents identified deposits from individuals and households as the primary source of funds. Direct deposits from Susu agents, groups and other Susu operations was the first-ranked choice of 13% of respondents, whereas 3% ranked owners’ contribution as major source of funds.

6 Except for Eastern region, the other 5 surveyed regions also happened to be the ones with Regional Cooperative Susu Collectors Association which together constitute the Ghana Cooperative Susu Collectors Association Limited. Of the 110 performing rural banks as of January 2000, 84 percent were in the 6 southern regions with the remaining 16 percent spread thinly across Northern, Upper East, Upper West and the Volta regions. The limited number of rural banks in the later regions reflects perhaps the low population density and/or the low level of economic activity. The 37 rural banks operating some form of Susu schemes were distributed as follows: Eastern (10), Western (9), Ashanti (6), Brong Ahafo (6), Central (3) Greater Accra (2), Volta (1). [Source: Bank of Ghana, Banking Supervision Department]
2.1 Savings Mobilization

1. On savings mobilization, the older commercial banks – Barclays, Standard and Commercial – are paying more attention to corporate and institutional banking, and to salaried workers. The mobilization of small, non-salaried savers appears not to fit into their new orientation. Their range of savings products are tailored to meet the specific needs of clients with minimum threshold deposits, high net-worth customers with the habit of investing their money for high returns, and to high value personal and corporate customers. It is their expectation that the lower banks and credit unions will fill the niche of small savings mobilization and eventually deposit the mobilized funds with them.

2. However, apart from cheque clearing facilities, there are less direct links between the commercial and development banks on one hand and the S&Ls and rural/community banks on the other for savings mobilization and lending purposes. Existing links are ad hoc and spontaneous, unsecured by any form of reciprocity. It appears that direct links for savings mobilization and lending purposes are hampered by (a) mutual distrust, (b) the changing orientation of the commercial banks towards urban and corporate banking and, (c) perhaps most important, by the tendency of the rural banks, credit unions and S&Ls to invest over 50 percent of their mobilized funds directly into safe government bills and bonds. The results are a) the incentives to seek mutually beneficial links in savings mobilization and lending therefore remain weak in both directions; b) the non-availability of low-cost funds to the commercial banks to finance medium and long term investment projects.

3. The S&Ls, rural/community banks are more closely connected with informal finance providers than with the commercial and development banks, although the newer commercial banks see linkages as necessary to secure sources of loanable funds.

4. Access of the S&Ls and rural banks to the cheque clearing system was a noted concern of many survey respondents, especially as they seek to compete in the semi-urban and urban areas. They see lack of access as an obstacle to their ability to meet
the needs of the growing small business clientele and to offer payment services as a logical complement to their increasing savings mobilization. In one respect, allowing access to the clearing system will be in line with the fact that these institutions already hold settlement balances (or reserves) at the Bank of Ghana. Therefore no additional requirements may be needed on the part of these institutions in their participation in the clearing system. Doing so, however, will mean two things. It will diminish to some extent the incentive for upward linkages with the commercial banks, and also increase the number of participants in the clearing system with the predictable additional resource cost.

5. Branching, mobilization centers, and itinerant banking services are the main tools of outreach for rural banks and the S&Ls. Lately many rural banks have extended themselves into semi-urban and urban areas. It is the view of rural bank managers that branching is one way to avert the cash flow problems if rural depositors simultaneously try to make withdrawals in case of negative income shocks or during the off-season. Even though the Bank of Ghana may see these initiatives as a problem, it has not halted the trend. At the risk of digression, available evidence showed that only 17 of the 115 active rural banks did not operate agencies as of end 1997. Of the 282 agencies and 60 mobilization centers only 63 agencies and 22 centers had Bank of Ghana approval. Indeed while the rural banks may be acting in ways not currently allowed by regulation, they are hoping for an innovative interpretation of the law or a formal regulatory relief. The Bank of Ghana too perhaps recognizes that the departure of the big commercial banks from many communities creates an intermediation gap that needs to be filled. Inasmuch as the rural banks and the savings and loan associations are expanding financial services and increasingly adopting susu schemes as their intermediation channels, there may be little or no reason then to discourage their initiatives.

6. There is growing interest to forge links with independent susu operators or failing that to mimic the operation of susu schemes. While eager to incorporate susu practices
into banking operations, there are efforts to transform conventional susu schemes to more innovative, non-rotating savings products.

7. Innovations are both in product and process changes. Product changes include the linking of savings and credit, building loans into savings cycles, and the adoption of fixed ratio credit-saving schemes. Process changes involve the use of outreach services, in-house susu collection schemes, and commissioned susu collection agents. These innovations are intended to (a) knock down the literacy barriers that deter demand for formal banking services, (b) remove the formality of banking hours and banking premises, and of completing savings and withdrawals forms, while preserving standards of banking practice; (c) make banking more convenient and understandable to the target clients; and in so doing encourage more positive banking habits.

8. Although it was not possible in many cases to determine definitely what fraction of deposit funds came from susu operations, whether in-house or through commissioned agents, it seems quite likely that an increasing share of deposits are coming through itinerant banking or through linkages in savings mobilization. Estimates range between 2 and 40 percent. This trend reflects a fundamental reorientation in savings mobilization not only by the rural banks, but the newer commercial banks as well.

9. The S&Ls, and several rural and community banks employ a variety of institutional innovations to increase their outreach in lending and to minimize default risk. The survey shows that the terms and conditions and the institutional arrangements by which groups are formed and screened, loans extended and collected, are different from the practices of the conventional commercial banks. The innovations reflect an increasing degree of discretion and flexibility in lending, mimicking some of the features of the informal sector providers. The use of their outreach activities as sources of information about clients and the nature of clients’ economic activity in the different workplace or communities enables lenders to classify borrowers into more homogenous risk classes when lending. This also provides for greater flexibility in
designing repayment schedules and to accommodate genuine emergency needs, leading to a greater benefit of eventual high loan repayment.

10. The mechanism for delivering credit via onlending, however, appears less developed although there is considerable interest in such a program and experimentation among the rural banks. A key observation is that most of the unsuccessful experiences have been due to shortcomings in forming groups, in delegated screening and political interference, and in administrative implementation of the lending scheme, rather than the inadequacy of the inter-linkage program itself.

11. Respondents were of the view that although moneylenders may have intimate knowledge about customers, their methods tried and tested, onlending through moneylenders only adds one more layer of uncertainty to the information asymmetry problem that lenders typically confront. The finding is not surprising in view of earlier findings that the use of moneylenders has not been a common or widespread method of allocating credit in Ghana. While moneylender-bank relationship may be weakening, susu-bank links may be on the rise. Growth in the latter links may precipitate the weakening of the former as susu evolves into multi-purpose saving-lending schemes.

12. Does sequencing matter? Unlike microfinance schemes that often stress credit first and saving second, it is the view of most of the S&L and rural banks that the artisans, traders, micro-enterprises are themselves the sources of loanable funds. Itinerant banking and susu schemes provide daily banking needs to their clients most conveniently, when and where most needed at least travel cost to the clients.

13. While the commercial banks, rural banks and the S&Ls see opportunities for linkages with the informal sector, especially in the area of savings mobilization, they do recognize that there are dangers of using the informal sector agents as legitimate intermediaries since these agents have no legal standing. Not unimportant for forging links is the lack of uniformity, regulation, and supervision of susu operations.
14. In fairness while there is some form of self-regulation of susu operations under the umbrella of cooperative societies and regional associations, the framework is weak, and the bye-laws not uniformly enforced.

2.2 Lending
The survey also solicited and obtained information about the lending practices of the financial institutions, and their willingness to forge links with moneylenders or Susu agents or associations for the purpose of increasing their lending outreach. Also of interest is whether they participated in an on-lending program, and the repayment performance of group-based credit schemes.

1. Many of the banks interviewed lend the conventional way to individuals and hardly to groups. To the extent that branch practices did not deviate markedly from overall bank approach, the responses generally reflected the bank’s orientation. Because of the low repayments rates and increasing risk of default, the commercial banks either have largely withdrawn or are withdrawing from lending to individual farmers in recent years. The new orientation is to broaden the customer base among salaried workers by offering innovative lending products, ranging from consumer credit schemes to small and medium enterprise finance schemes. Consumer credit schemes or personal loans aim at salaried/urban workers. This shifting orientation means that access to credit facilities for non-salaried workers, especially women most of whom are small traders, are gradually being given a lower order of priority by the major commercial banks.

2. Many rural and community banks employ a variety of institutional innovations to increase their outreach in lending and to minimize the risk of default. Both the institutional arrangements by which groups are formed, loans extended and collected, and the rates charged, are markedly different from conventional bank lending. This
reflects the institutional fact the rural banks and S&L, and for that matter the credit unions, are restricted to operating locally and cannot diversify their lending risks as easily as the commercial banks operating over a broader area. They are especially vulnerable to severe local difficulties. The hypothesis that loan repayment performance is influenced by the process of formation of groups, size, and whether the lending program has a savings service component was confirmed by the survey results. Also, repayment performance of groups initiated by external program agents is likely to be low. Group size matters and credit programs with saving service component are likely to be more efficient and effective than without.

3. Offering savings services improved repayment for both individual and group lending programs. Savings accumulated often through some form of susu schemes increase the financial discipline of loan recipients. In all cases, the accumulated savings serve as the basis for eligibility of credit, and, except for lending initiated through an external program agent, also determine the size of the loan. A key observation here is that this institutional innovation helps to overcome somewhat the problems associated with physical collateral in conventional banking. As one bank manager observed, “holding deposits, no matter how small, as collateral persuades individuals to repay their loans better than they would by using their farms”. The implication here is that while credit is very useful, accumulated deposits may be of greater value as a means to handling risks and uncertainty in their lives.

Group formation has been a critical aspect of on-lending programs. Some have failed whilst others have succeeded. The Women in Development program (Case Study 4), modelled on the Village bank concept practised by the Grameen bank in Bangladesh, share many of the design features of a successful on-lending program, and also illustrates the constraints of on-lending. The survey information suggested that in instances where an individual or an NGO has taken the initiative or bears the cost of organizing groups, groups have tended to be large, between 15-20 and less homogeneous. Many rural banks participating in on-lending programmes cited this as the major shortcoming. For example, in the Brong Ahafo and Ahafo Ano areas where the International Fund for
Agricultural Development (IFAD) on-lending program is perhaps most active, the high default rates were attributed to the mechanism of group formation and the mode of screening and selection of loan recipients. According to the participating banks, the screening of groups is hampered by the fact that the District Chief Executive and the District Coordinating Director of Administration play active roles.

The experience of participating banks in on-lending program underscores the dangers when government helps to organize and act as catalyst in the formation of groups. While government participation may provide a form of social capital from which all members can benefit, it does not necessarily lower the information and monitoring costs associated with loan transactions. Even when there is joint and several liabilities, political involvement in forming groups only adds to the free-rider problem commonly associated with large groups. Members see the group as ad hoc- a loose, political cooperative- and the program as transient, unlikely to lead to future borrowing. Individual members therefore do not see default by any member as of any consequence to their future demand for credit. The risk of lending falls on the bank.

In addition to the general dissatisfaction with the political interference in the screening and selection of groups, a common complaint by the rural banks was the high administrative cost of running the on-lending program. Much of this was attributed to (a) the high cost of the initial lending to them by the sponsoring NGO or the primary lending commercial bank, and (b) lack of logistical support in the monitoring of loan use. The high cost of lending from donors or the granting agencies (about 20% in 1999/2000 to most of the rural banks) emasculate the ability of the participating banks to cover the high monitoring costs of agricultural lending and the potential default risks inherent in rural on-lending. In one instance, the Standard bank offered credit to a rural bank for on-lending at 32%, at a time when the rural bank was lending to its clients at 35% per annum. This concern was echoed by the Ashanti Susu Collector’s Cooperative Association which unlike the rural banks, was in a much weaker position to bear the risks of on-lending.
2.3 Moneylenders and On-lending

Will formal and semi-formal institutions exploit the experience of moneylenders by making them loan officers? Only 9% of the respondents responded positively to this question. 78% of all respondents (86% of rural banks and S&L’s and 64% of formal sector banks) rejected the prospects of actively doing business with moneylenders. Many seasoned bank officials did not want to associate with moneylenders because success stories have been few and far between in their experience. Fair or otherwise, this stigmatised perception appears to manifest in the institutional hands-off attitude. Respondents were of the view that although moneylenders may have intimate knowledge about clients — their character and background — problems of moral hazard and the risk of self-dealing weigh heavily in their unwillingness to forge lending links. One bank manager remarked that on-lending through a moneylender only adds one more layer of uncertainty to the information problems that lenders typically confront. There was concern with the bank’s reputation. Usurious loan contracts could ruin the reputation of any bank known in the community to be using moneylenders as conduits for lending. The preferred strategy is to engage in direct or group lending, but only after attracting deposits and having had the opportunity to learn more about clients or finding ways to minimize default risk. It was not apparent from the interviews whether some of these institutions had actually had unpleasant experience with moneylenders than they were willing to admit it.

Aryeetey in his 1992 study of susu operations noted that the role of moneylenders need not be exaggerated. His survey evidence then showed that the use of moneylenders has not been a common or widespread method of allocating credit in Ghana. Indeed, while moneylender-banks relationship may be weakening, susu collectors-banks and S&L’s relationship may be on the ascendancy. The growth in the latter links may precipitate the weakening of the former since susu schemes are evolving into multi-purpose saving-lending schemes.

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7 A shortcoming of the present study is that there was no opportunity to interview moneylenders on the subject of on-lending, whether they are loosing grounds relative to institutional lenders, and the main sources of their loanable funds. Aryeetey and Gockel (1991) reported a decline in the number of registered moneylenders in the Greater Accra and suggested that the phenomenon may be nation-wide.
2.4 Innovative Schemes in Susu Operations

The fieldwork revealed several variations on the conventional rotational susu. There is a growing desire on the part of some banks and the S&L’s to influence the desire to participate in independent susu operations, by providing clients with innovative, non-rotating savings products which treat all members as having similar or equal rate of time preference. The majority of the rural banks surveyed and all the S&L’s do not follow the traditional single collector system, do not charge the equivalent of one-day commission, and operate on longer cycle of 12 instead of 4 weeks. In most cases, contributions during the first three months of the saving-credit cycle are treated as non-interest-bearing current accounts and only converted, in whole or in part, into an interest-bearing instrument at the onset of the credit phase of the program. The keys to these are door-step savings mobilization; improving client’s overall access to deposit and withdrawal services; developing and enhancing trust; and providing clients the opportunity to borrow in the course of the cycle or at the end of the cycle using the contributions as a collateral. From the standpoint of the service providers, these innovations are necessary to circumvent the structural and information problems that hinder effective mobilization by conventional commercial banks. For example, the use of a regular single or a team of agents for their outreach services is a powerful means of establishing social network and trust, which subsequently enables more complex financial transactions (such as withdrawals) to take place.
First Allied Savings and Loan Ltd.

Established 1996, First Allied Savings and Loan Ltd. sees outreach as an integral part of its operations. To this end, it employs 3 marketing agents responsible for distance banking, customer prospecting, and outreach programs. The key features of its operations are listed below.

- **Basic Susu**
  - Members contribute between 3,000 and 15,000 daily for a cycle of 90 days. Like the conventional Susu, accumulated contributions during the cycle are non-interest bearing, and customer may also withdraw accumulated savings at end of cycle.
  - But unlike the conventional Susu, there is no charge of one-day contribution in the cycle, customer is eligible for a soft loan equivalent to a third of accumulated contributions at end of 90 days (or the cycle).
  - Customer may also withdraw the entire accumulated contributions to date or convert to interest-bearing savings account.
  - The soft loan is collateral free and carries a substantial discount on interest cost at nearly 50% of commercial lending rates.
  - Loan repayment is over the 90-day cycle with daily contributions of \( \frac{(Loan + Interest)}{90} \). This is in addition to the regular basic Susu contributions.
  - Basic Susu has been in operation for 2 years with 95% recovery rate.

- **Golden Susu**
  - Members contribute between 16,000 –50,000 daily for a cycle of 90 days.
  - To be eligible for a loan, customer must convert 50% of accumulated contributions into an interest-bearing account as loan security.
  - Customer is eligible for a loan equivalent to 100% of accumulated contributions, again at a substantial discount of nearly 50% of competitive market rate.

- **Golden Plus Susu**
  - Members must go through at least 2 cycles of Golden Susu with minimum daily contributions of 50,000.
  - Convert 50% of accumulated contributions into an interest-bearing account as loan security.
  - Eligible for a loan equivalent to 100% of accumulated contributions, again at a substantial discount of nearly 50% of competitive market rate with a three-month maturity. Also eligible for commercial loan and overdraft facilities at commercial rates.

Even in the early stages of their development, the S&L’s and the majority of the rural banks see outreach service as an essential aspect of their operations. The Atiwa rural bank saw its deposit base increased nearly three times over 2 years since its inception of Susu scheme. The rapid growth of susu operations by the S&L’s is striking evidence that great many traders, artisans and small businesses have found them able to meet some of their financial needs better than the other financial institutions. The Susu operations by 1st Allied and Savings & Loan is representative of contemporary innovative products.
3. Concluding Observations and Recommendations

There is growing interest in forging linkages and the institutions surveyed recognize the need to do so in order to broaden their customer base, stay competitive, and practice banking in ways understandable to the majority of their clients. Micro-finance or the directing of credit to the “rural poor” appears not to be the central focus of the pursuit of linkages. The findings suggest mostly favourable consequences from the emerging trends in forging linkages more so in savings mobilization than in lending. The incorporation of susu schemes in formal banking by the S&Ls, rural banks, and some of the newer commercial banks would likely improve domestic savings mobilization, encourage positive savings habits among small savers, and increase the flow of funds through the banking channels. There is also the potential for the bigger commercial banks to forge linkages by setting up mutually beneficial savings and lending schemes and persuading the second tier banks to join.

Informality, flexibility and adaptability are the basic strengths of the informal sector. But some institutional links are useful in order to craft order, thereby mitigate problems and realize mutual gains. Promoting linkages may require some form of institutional linkage, some monitoring mechanisms, a two-way flow of funds and information services, and reciprocity. Such relationships, however, should develop on their own. The Bank of Ghana should not impede such initiatives in so far as the soundness of the banking system is not compromised. Its role is to encourage it and to ensure order. Progress in forging linkages will no doubt be shaped by the changes in the economic environment, the prospects of mutual benefits to the financial service providers, and reform of the financial system that alter the constraints faced by the banks, savings and loan associations and the rural banks.

It is difficult to pick up in a single survey all the striking developments in the attempt to forge linkages in the entire financial system. The analysis here highlights the need for more field studies. Such studies are needed in order to examine the practices and activities of the different financial service providers for the purpose of trying to determine where there are gaps, in what ways gaps may be filled, how gaps are being
filled, and what public policy might realistically and reasonably expect to do and to achieve. For example, the direction of the second tier financial institutions — the savings and loans, the credit unions, and the rural banks — and their coordination should be worthy of further examination. It may be a mistake to look at the proliferation of these institutions merely as providing more channels for savings and credit, without worrying about the stability of the financial system and their role in the conduct of monetary policy and overall macro management.

Unanimously, the managers of rural banks believe that branching is necessary to enhance their ability to provide effective rural financial intermediation. Overall, the rural banks see greater opportunity in the semi-urban and urban areas to engage in extensive backward linkages with informal finance providers or in savings mobilization schemes than is possible in their licensed rural areas. But, not known for their managerial capabilities, geographical expansion creates new concerns.

- Will branching change the role of the rural banks as they were originally mandated to be?
- Will success in urban savings mobilization undermine the viability of rural banking or necessarily foster greater upward linkages with commercial banks?
- If full branching is permissible, then should rural banks and for that matter the S&Ls be permitted to offer a full range of financial intermediation services just like the commercial banks, and in so doing cease to be second tier institutions in the financial system?

All these issues need deeper examination. The need to forge links should also be more than of passing interest to the central bank since weak linkages limit the impact of credit policies and interest rate changes on the economy. It must actively seek to facilitate the process by looking at concerns that may inhibit such linkages. Regulatory concerns center on the type of financial services that rural and community banks, credit unions, and savings and loans can offer, and the type of affiliations that they could have with other formal and informal financial service providers.
The Bank of Ghana should also be concerned with the reserve requirements that direct domestic savings resources into government bills and bonds and away from private uses. It limits opportunities and diminishes incentives for mutual beneficial linkages among financial service providers for productive credit allocation purposes.

a) The safety of deposits from susu collections whether through in-house susu operations, commissioned agents, susu groups or independent collectors, and the movement of funds between branches and mobilization centers of rural banks, should be of interest to the Bank of Ghana.

b) Linkage initiatives that seek to employ the dense network of the postal system should be given due considerations. Such a network could facilitate nation-wide funds transfer, and also serve as a conduit for local susu operators to deposit funds for safe custody in areas where banking facilities may not be readily available.

c) There is little doubt that the susu schemes have significant role to play in the development of the financial system. Some concrete recommendations that may be taken to encourage linkages in this direction include:

- Give legal status to susu groups and independent agents. This involves registration of susu groups and agents with the Registrar General Department with supervisory role assigned to the Regional Cooperatives and the Department of Cooperatives.

- Independent agents must also be registered by their respective District Assembly to strengthen local oversight. Registration with Registrar General Department must be a prerequisite to obtaining local operating license from the District Assembly. To be effective, there should not be too inflexible standards of eligibility criteria, lest they loose their comparative operational and cost advantages.
• Provide education and training to susu agents and operators to improve on skills in such areas as bookkeeping and accounting procedures, membership lists.

• Strengthen Regional Cooperative associations to operate under the same by-laws under the Department of Cooperatives. The demand for local flexibility notwithstanding, there is no reason why there should not be uniform standards of performance for regional associations.

There is little doubt that the susu schemes have significant role to play in the development of the financial system if only to improve on the flow of funds and to improve on the transmission links in the conduct of monetary policy. This can be effectively achieved only when the channels of linkages and collaboration are fully understood by both parties and the right measures put in place to ensure that linkages are mutually beneficial.
### Appendix 1  Survey Results

**Number of Respondents**

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<td>Deposits from individuals</td>
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<td>promote institutions that provide services at market prices</td>
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<td>14</td>
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<td>6</td>
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<td>sponsor credit guarantee schemes</td>
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<td>3</td>
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<td>8</td>
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<td>27</td>
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<td>Downward links in saving mobilization</td>
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<td>11</td>
<td>6</td>
<td>21</td>
<td>36</td>
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<td>25</td>
<td>36</td>
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<td>3.2 Duration of relationship</td>
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<td>Less than 1 year</td>
<td>8</td>
<td>2</td>
<td>2</td>
<td>12</td>
<td>73</td>
<td>14</td>
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1-3 years  2  4  3  9  18  29  43  28
4-5 years  0  1  1  2  0  7  14  6
Over 5 years  0  7  1  8  0  50  14  25

3.3 Existing linkages have been most beneficial in the areas of:
  Mobilizing savings  4  6  4  14  36  43  57  44
  On-lending  0  1  0  1  0  7  0  3
  Collecting loans  0  1  0  1  0  7  0  3
  Gathering & sharing information  1  3  1  5  9  21  14  16
  Clearing facilities  6  3  2  11  55  21  29  34

3.4 Respondents with some form of Susu operations
  3  13  7  23  27  93  100  72

3.5 Respondents with formal links with some form of Susu operations
  1  3  3  7  9  21  43  22

3.6 Respondents with in-house/own Susu operations
  3  12  7  22  27  86  100  69

3.7 Respondents with unsuccessful links with Susu operators
  5  7  0  12  45  50  0  38

3.8 Respondents engaged in some form of on-lending
  2  5  2  9  18  36  29  28

4.1 If you have no links with other MFF, it is because such linkages are
  Not needed  1  0  0  1  9  0  0  3
  Not profitable  5  0  0  5  45  0  0  16
  Only potentially profitable  3  0  0  3  27  0  0  9

4.2 Downward linkages are problematic because
  less dependable record-keeping  8  8  1  17  73  57  14  53
  high transaction/monitoring costs  3  3  4  10  27  21  57  31
  informal sector agents likely to default  0  0  0  0  0  0  0  0
  lack of capacity to monitor links  2  2  2  6  18  14  29  19

4.3 Downward linkages are beneficial only in
  Savings mobilization  6  3  1  10  55  21  14  31
  On-lending  0  0  0  0  0  0  0  0
  Both  5  11  6  22  45  79  86  69

4.4 There is a view that because moneylenders are generally known to possess better local information, banks lending institutions should consider some form of arrangements with money lenders for purpose of on-lending. Banks will increase their lending capacity
  Yes  1  1  1  3  9  7  14  9
  Somewhat  3  2  0  5  27  14  0  16
  No  7  12  6  25  64  86  86  78

4.5 Susu agents cannot grant longer term loans because of the short-term nature of their mobilized funds. Indicate your willingness to link with Susu operations for on-lending (rank 1,2,3,4,5: 1= very willing, 5=least willing)
  Very willing  2  1  5  8  18  7  71  25
  Maybe  2  5  2  9  18  36  29  28
  Least willing/unwilling  3  0  0  3  27  0  0  9

5.1 Should all Susu agents become licensed professional agents/certified private agents?
  Yes  11  14  5  30  100  100  71  94

5.2 Do you see any benefits in professionalization of Susu agents?
  Yes  9  14  7  30  82  100  100  94
Appendix 2: Case Studies

Case Study 1: Savings Mobilization by Akuapim Rural Bank

Akuapim Rural bank is engaged in striking experiments by operating 3 main agencies, and 6 mobilizing units in the Akuapim district.

- 80% of its sources of funds are deposits from individual members. About 50% of this total come from bank’s mobilization exercises.
- Its mobile unit opens 3-4 hours or 2-3 hours daily in selected villages, depending on the number of customers at a particular center.
- Mobile unit not only takes deposits, but also assists customers in completing loan application forms. Only when the application is nearly complete that the customer is invited to visit the main office.
- In addition to the bank’s own mobile unit, the bank engages commissioned Susu agents.
  - Commission is tied to amount of savings mobilized
  - Agents are recruited based on careful screening and background checks and successful applicants are typically members of the community in good standing.
  - Agent must be registered with the district assembly and provide guarantors and must also have deposit with the bank as security.
  - Bank provides in-house training
  - Daily monitoring is key to ensure the safety of deposits in transit
  - Bank is planning to take fidelity insurance on the approximate amount of daily deposits mobilized in transit
  - Although the bank maintains the accounts of 3 Susu Associations independently operated, the bank currently provides them with no special facility.
  - The bank is reluctant to take the risks associated with the independent Susu agencies because of the high monitoring costs and enforcement of contracts.
  - The bank rather sees institutional or in-house Susu as a better alternative to dealing with existing agencies. In-house field mobilizers serve the dual purpose of information gathering about the pace of economic activity in the local economy as well as information on which group of customers are doing what at each time of the year.
  - Has two moneylender clients but transactions are at arms length. Sees the risk of inter-linking as too high.
Case Study 2: Savings Mobilization by Adonten Rural Bank

Pilot Saving Mobilization Scheme: Commenced on April 1, 1997

Operates 2 mobilization centers — Kukurantumi and Asafo — daily by a staff of 2. In January 2000, bank also started operating with 5 commissioned Susu agents contracted specifically for the task of saving mobilization. Catchment area is divided into 5 zones — Tafo, Asafo Akyem, Osiem, Maaso, and Kukurantumi.

- Bank provides agents with bicycles
- Agents carry passbooks, bank card, and pay-in voucher on their rounds.
- Collections are duly recorded and deposited at the bank or at one of the mobilization centers on daily basis. Collectors are picked up daily by escorted bank vehicle to bring their collection to the area mobilization center or to the central office in the area.
- Bank conducts random checks on daily collection by a bank staff. A bank staff may be selected on a given day to accompany agent on the rounds or demand to visit selected customers in a given zone.
- Average daily collection (Jan-May 2000) of all agents and mobilization centers $5,374,812.
- Average daily collection per agent (February-June 2000) = $0.5265m.
- Agent receives a commission of 1.5% of collection. Average daily commission is $7900 or $160,000 monthly.

Recruitment of Agents:
- Position is advertised through local media followed by tight screening of applicants including background checks by a board.
- Successful agents must provide sureties/guarantors who must be well known in the community and in good standing.
- Rural bank provides some minimal training in record-keeping.
- Agents are signed to renewable 3-month contracts.

Why did the bank go the commissioned route rather than use in-house salaried staff?

Bank has experimented with the use of staff for outreach services. The project was abandoned because of the lack of discipline and the difficulty of enforcing collection. Some of the staff lacked the incentives to maximize daily collection since their salary was not in any way tied to the collection. Banks received complaints from customers about the infrequent collection and the fact that they had to deal with different faces on different days depending on the availability of bank staff. Commissioned agents were considered a better alternative. The bank presently has no insurance on the agents and is considering buying fidelity insurance to cover cash in transit. The bank at the moment relies on its general insurance policy to cover all cash in transit from their mobilization centers.

It is the view of the bank that the arrangements have been most beneficial in savings mobilization, extending loans, collecting loans, and in gathering information about customers. Agents are used when processing loan applications, in repayments which automatically comes out of the customer’s daily collection. The increase in deposits has helped to solve the bank’s liquidity problems, especially during seasonal cash needs by the different group of customers. The bank has had no need to obtain credit from local commercial banks in order to meet some of its seasonal cash needs.
Case Study 3: Women in Development on-lending Program (Lower Pra Rural Bank)

**Goal:**
To contribute to the elimination of chronic hunger and malnutrition by increasing incomes and improving household food security, health and nutrition practices through credit with savings associations.

**Background:**
Formed in 1992 in collaboration with Freedom from Hunger, an American private Voluntary Organization, for the purpose of establishing a credit with education project in the bank’s catchment area. Uses the Village Bank concept practised by the Grameen Bank in Bankgladesh and the Bank Rakyat Unit Desa in Indonesia.

**Operations:**
The lower Pra Rural Bank operates in the Western region with head office in Shama. Operates 8 branches, 1 mobilization center and a market circle Susu operations. Main customer base in catchment area is predominantly small scale farmers, fishermen, and small-scale entrepreneurs.

As of March 2000, the Women in Development program was made up of 51 Credit with Savings Associations (CSA) in 51 communities. Each CSA is made up of a minimum of 3 cells to a maximum of 7 cells, or solidarity group. Each cell has a membership of 5 people. The average size of CSA was 5 cells or 25 members. Each CSA is run by an executive committee.

- **Group formation:**
  Each cell has a probationary period of 3 months of education, screening and self-selection. The education component, led by bank staff as field agents, focuses on basic health and nutrition needs. In addition to weekly business sessions, learning sessions address issues of micro-enterprise development, credit association management, the use of loans for productive economic activities and loan repayment. The focus here is as much on ensuring high repayment rate as on promoting borrower welfare through the education programs.

- **Each member must participate in daily savings Susu program during the first 3 months. The deposit of the CSA is one of the prerequisites for granting credit facilities after the first 3 months of the program. Uses group savings as loan collateral. Peer selection and cross-guarantees by the CSA enhance the effectiveness of the program.

- **As of March 31, 2000 the program has granted a total loan of about US$344,200 to 9670 individual rural women. Loan size ranged between US$50 and US$120 based on the economic activity of the member for duration of 4 months, and at 3% discount from the commercial lending rate.

- **Although no CSA has defaulted in the repayment of loans, few members have posed problems for some cells in the coastal communities during the off-season.

- **The Women in Development program has been a major income source to the bank. Total interest income as a percent of total loans granted increased from 9.5% in 1997 in the first year of operation to 20.5% in 1998, and 19.3% in 1999.

- **The collaboration with Freedom from Hunger ended in 1996. The bank has since depended solely on its deposits to finance the credit program. The popularity of the program, the growth of CSA, and increase in loan sizes from cycle to cycle have meant that the bank is unable to make credit available as much as they would like. Even if overstated, the bank’s view is that this may have created opportunities for moneylenders to fill the credit gap. A matter that concerns the rural banks as well as S&L associations is that the statutory reserve requirement of 52% of deposits unduly restricts their credit granting activities.**