

THE MODEL FOR LINKING SAVINGS AND CREDIT GROUPS WITH BANKS IN AKWA IBOM STATE, NIGERIA

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ABSTRACT

This paper assessed the operation of the financial linkage of self-help groups with banks in Nigeria, which was introduced in 1991 to enhance the performance of loans guaranteed under the Agricultural Credit Guarantee Fund Scheme [ACGFS]. It utilized simple statistical tools and the multiple regression analyses to assess the lending and savings component of the linkage.

The results show that project choices of some groups are correlated: groups only sign documents that members are jointly liable to the banks but in actual fact, the operation of the linkage does not encourage joint liability of groups in loan repayment; and groups are generally effective in making the mandatory savings when they have not obtained the loans.

The linkage program will greatly be enhanced if the design of the linkage encourages joint liability in loan repayment and if the savings instrument is adequately flexible such that groups can use part of the mandatory savings to repay loans when group income falls short of the group's financial obligations.

Key Words: Financial Linkage, Self-Help groups, Joint liability, Banks.

INTRODUCTION.

Several financial market innovations have been tried with the Nigerian agricultural sector. Of these innovations, the one that has the potential of enhancing credit delivery in the sector is the model for linking informal groups with banks.

The Linkage Model [LM] was introduced in 1991 to enhance lending under the Agricultural Credit Guarantee Fund Scheme [ACGFS], which had dwindled in the late 80's as a result of non-performance of loans [Eyo, 1995]. According to the fund secretariat of the Central Bank of Nigeria [CBN], the LM operates on four principles: namely, a group or voluntary organization enlist in the linkage with a partner bank; obtains group loans from the bank; determines amount of credit based on size of group savings; and regulates by status as well as legal norms the liabilities of the group/association vis-à-vis the bank. An interested self help group enlists in the program in the nearest commercial bank branch where members would sign documents that binds the group to a joint liability concerning the group's

business relations with the bank branch; opens a savings and current account with the bank branch for savings and loan transactions; and agrees to inform the bank promptly on changes in cycles of contribution, membership, persons responsible for groups activities with the bank and decisions to liquidate the credit group. The LM allows autonomy of groups in their internal affairs but interested groups must have bye-laws, copies of which must be submitted to the association of self help groups and the commercial bank branch.

On completing registration formalities, a Self Help Group [SHG] decides on the amount and cycle of savings and commences saving on the group savings account. Monies so deposited serve as security for the banks and the SHG's are not permitted to withdraw from the savings account except in cases of termination of membership or credit group's business with the bank. On consistently saving for 12 months, the SHG applies for and obtains short-term loan in multiple of the amount of savings made. After the initial loan, subsequent

loans are automatic provided that the loan repayment and mandatory savings obligations were fulfilled within the term period.

ON THE THEORY OF GROUP LOANS.

In group lending, a group obtains loans without collateral security and distributes to members that accept joint liability for the fulfillment of repayment obligations. There are two main theories of group lending, namely the transaction cost and the joint-liability based theories. The transaction-cost based theories emphasize that coordinating lenders dealings with borrowers in a group can save loan processing, screening and collection cost provided the projects to be funded are simple and similar in characteristics, time path of returns and location. According to Ghatak and Guinnane [1998], it is only slightly more expensive to administer a group loan than to administer a single loan. On the other hand, the joint liability theories explain how joint liability makes borrowers to behave predictably. These theories emphasize that joint liability is effective in solving problems of adverse selection, moral hazard, auditing cost and enforcement of loan contracts, commonly faced by formal financial institutions that lend to the poor. The ideas of joint liability vary considerably depending on the lending scheme. Existing literature indicates that joint liability could mean the entire group being denied further access to loanable funds in future if the group defaults or it may mean that the entire group repays members loans in cases of default. Whatever the case, making members jointly liable to repay group loans has been found to influence group formation towards positive assortative matching, and induce group members to behave predictably in project selection, loan utilization and loan repayment. In particular, Reinke (1998) and Adams et al, (1979) claimed that group loans reduce default risk, loan transaction cost; and reaching out to the beneficiaries in a group enhances the introduction of technical services.

For the group members, operating in groups makes production and marketing technically simpler, allows for less conflict of interest, more mutual trust, less authority of office, more face-to-face interaction, less corruption, nepotism and political patronage [FAO, 1986]. A common feature of most of these groups include mobilizing savings for rural development, giving loans to members, monitoring loan beneficiaries and utilizing group pressure to achieve satisfactory levels of loan repayment [Adams, 1990; Stiglitz, 1990; Udry, 1990]. In fact, in many communities groups with satisfactory levels of cohesion and homogeneity influence the production and marketing decisions of members, enforce production and marketing targets as well as loan contracts satisfactorily. The relative success of groups in this regard according to Yaron et al, [1996] result from the ability of the groups to attain economies of scale and scope, mitigate information asymmetry, and their effectiveness in peer monitoring and pressure. Today, because of the ability of groups to achieve satisfactory levels of loan repayment many countries have overtime attempted to give loans to small operators, particularly in the agricultural sector, in groups. In particular, there are four successful micro-finance schemes, which give uncollateralised loans to beneficiaries in groups. These include the finance schemes of the bank for agriculture and agricultural cooperative [BAAC] of Thailand; the village bank of Bank Rakyat, Indonesia, the Grameen bank of Bangladesh, and the small enterprise foundation of South Africa.

The financial linkage of SHG's with banks in Nigeria commenced in 1992. By 1995, as many as 361 SHG's with 8,997 members enlisted in the programme; the total savings mobilized was N5.16 million, loans disbursed to 229 SHG's was N22.56 million, but aggregate loan repayment was only 63 percent [Eyo, 1995]. Since 1998 when the association of SHG's was introduced into the LM, it has been obvious that the major problem of the linkage is how to improve the loan repayment rate. This

paper assesses the operation of the Linkage in Akwa Ibom State, identifies problematic areas and suggest ways in which the operation of the linkage can be made to optimize the benefits of lending with joint liability.

METHODOLOGY

This study uses principally secondary data based on nine years operation of the financial linkage of self help groups with banks by commercial banks in Akwa Ibom State. The report is descriptive using tables and simple descriptive statistics. The linear multiple regression analysis is also used to assess the savings component of the linkage. The model estimated is as follows:

$$Y = a_0 + a_1X_1 + a_2X_2 + a_3X_3$$

Where;

- Y = Savings mobilized in naira,
- X₁ = Number of members,
- X₂ = Duration of savings in months,
- X₃ = Size of savings per month (in Naira).

a₀ = constant, and

a₁, a₂, a₃ are coefficients.

RESULTS AND DISCUSSION

GROUPS IN THE LINKAGE PROGRAM

Between 1992 and the year 2000, only 16 self help groups enlisted in the linkage program and members signed documents that binded them to the joint liability of the group's business relation with the bank. Two groups enlisted in the linkage in 1992, one in 1993, two in

1997, six in 1998, one in 1999 and four in 2000. These groups include two cooperative societies, two groups of operators in the artisarnal fishery sub sector and twelve groups of operators in the crop sub sector. Although the mean membership per group is 10 persons, Table 1.0 shows that 75% of the groups had 5 - 10 members, 19% of the groups had 11-16 members, and only 6% of the groups had 17 or more members.

OPERATION OF THE LINKAGE ROGRAM.

On enlisting in the linkage program, each group commences the mandatory savings with the commercial bank branch. Each member of the group saves N100.00 [one hundred Naira] per month such that at the end of the month a group of ten members make a mandatory savings of N1000.00 [one thousand Naira]. However, the stipulation of the 12 months mandatory savings period had been violated. Instead, on meeting the required amount of savings groups were permitted to obtain loans at a savings-to-loan ratio of 1:4. The loans were then disbursed directly to the individual

benefiting members of the groups and all the members of such groups obtain loans at the same time. Between 1992 and 2000, the loans disbursed to 186 members in the 16 self-help groups was about N 1.83 million.

An analysis of loan repayment presented in Table 2.0 shows that 18.8% of the groups had repaid all the loans, 31.3% repaid between 80 - 99%

TABLE 1.0 DISTRIBUTION OF SELF HELP GROUPS BY SIZE.

MEMBERSHIP	FREQUENCY	PERCENTAGE
5 - 10	12	75.00
11 - 16	3	19.00
17 and above	1	6.00
Total	16	100.00

Source; CBN, Fund secretariat

Apart from the cooperative societies, other groups exhibited occupational homogeneity. In particular, we have groups of artisarnal fishermen, groups of cassava farmers, groundnut farmers and cassava/groundnut farmers.

of the loans and only 6.3% of the groups had repaid between 60 – 79% of the loans. In fact, 25% of the groups had not commenced repayment at time of research.

On the other hand, savings after obtaining loans had declined. In fact by 2000, participating groups had made only 82.5% of the total expected savings. However, when an assessment of the status of the savings and repayment component of the linkage is made (see Table 3) the result reveal that 12.5% of the respondents had defaulted on both savings and loan agreements whereas 12.5% had defaulted on savings but did fully repay the loans. Those groups that defaulted on savings but were servicing their loans as well as those that were doing well in savings and completed loan repayment constituted 6.3% respectively. The groups that were doing well in savings and were servicing their loans constituted only 37.50%. However, only 25% of the groups had completed the mandatory saving and had not commenced loan repayment. The savings component is important for the success of the linkage program since it is a means whereby groups build satisfactory levels of collateral security with the banks. However, in the design of the linkage, the amount of savings mobilized depends on group membership strength, duration of savings and amount of savings per month.

A regression model estimated to assess the effectiveness of these variables in ensuring satisfactory levels of savings mobilization produced the following results.

$$Y = 22277.28 - 565.08X_1 - 306.56X_2 + 1774X_3$$

t = -0.39 t = -3.45* t = 1.22

adjusted R² = 62%; [* significant at 1% two tailed test]

From the model estimated, it is obvious that the measures adopted in the linkage to ensure adequate savings mobilization is 62% effective and only the duration of savings has had significant effect on the actual savings mobilized. Whereas the size of monthly saving is positively related to the actual amount of savings mobilized under the linkage, the other variables are

negatively related. Invariably, actual savings increases as membership strength and duration of savings decreases. These imply that smaller sized groups are more effective in making the mandatory savings; also groups generally do well in the mandatory savings during the early [pre-loan] period of the linkage.

There are other shortcomings of the linkage program: First, outright implementation of a savings to loan ratio of 1:4 entices risky borrowers to default. In the linkage program, the net benefit of making the mandatory savings and fulfilling the repayment obligation is automatic access to loanable funds. To a risky borrower, this arrangement makes the benefit of defaulting greater than the discounted net benefit of continuous access to loans.

Second, disbursing loans to all members of the groups at the same time as practiced by the operators of the linkage limits the scope of joint liability of the linkage to denial of future credit and forfeiture of the mandatory savings. When all borrowed funds pass directly from the banks to the individual group members, it implies that groups are not involved in the on-lending and as such no on-lending interest accrues to the groups. Indirectly the onus to repay loans is taken from the groups and given to the benefiting members. Invariably groups just sign documents accepting joint liability, but in

TABLE 2.0 DISTRIBUTION OF GROUPS BY PORTION OF LOANS REPAID

PERCENTAGE OF LOANS REPAID	FREQUENCY	PERCENTAGE OF GROUPS
100	3	18.8
80 – 99	5	31.3
60 – 79	1	6.3
0.00	4	25.0

SOURCE; Fund Secretariat, CBN.

TABLE 3. PERFORMANCE CHARACTERISTICS OF GROUPS

S. No.	STATUS OF GROUPS	FREQUENCY	PERCENTAGE.
1.	Default on savings and loans	2	12.5
2.	Default on savings but fully repaid loans	2	12.5
3.	Default on savings but servicing loans	1	6.3
4.	Doing well in savings and fully repaid loans	1	6.3
5.	Doing well in savings and servicing loans	6	37.5
6	Doing well in savings but yet to start repayment	4	25.0

Source; Fund Secretariat, CBN.

actual fact, the design of the linkage does not encourage groups to use group pressure to enforce loan contracts and does not encourage groups to be jointly liable in repaying erring member's loans.

Third, the groups are generally denied access to their savings until loans are completely repaid or groups are liquidated. Invariably, the groups have no reserve to fall back upon whenever members income are not enough to meet loan repayment and the mandatory savings obligations.

Fourth, the linkage specifies a mandatory saving of N100.00 [one hundred Naira] per beneficiary each month. This amount does not encourage satisfactory savings mobilization for the linkage program.

SUGESTIONS FOR IMPROVEMENT.

1. While all members participate in the mandatory savings, loans should always be given to some members of a group while other members wait on the initial beneficiaries to repay. The part of the loan withheld by bank must be deposited in the mandatory savings account to yield interest for the group. This will help utilize group pressure to enforce loan contracts.

2. Outright implementation of the savings to loan ratio of 1:4 should be discouraged. It will pay the linkage more if

participating groups graduate from a saving to loan ratio of 1:2 to 1:3 and get to 1:4. In other words, during the first loan, the ratio should be 1:2; when this is repaid, the next ratio is applied such that only risk free groups can obtain loans at a savings to loan ratio of 1:4.

3. The linkage program should not foster groups that show signs of homogeneity in project choice and outcomes. A group of cassava farmers or artisanal fishermen have the same earning pattern and operate under the same environmental and economic conditions. If pest attacks the cassava farms or the fishermen had a period of unfavorable fishing condition at sea, the member's income will be affected and no one can repay loans for the others. Heterogeneity in project choice and outcomes will be of immense benefit if members must be jointly liable to repay group loans.

4. The linkage program should remove the restriction on the amount of monthly mandatory savings and allow the group's access to the mandatory savings, at least up to a specified amount. If the restrictions are removed, groups will surely deposit excess liquidity arising from monthly dues, enrolment fees, annual membership subscriptions, grants and levies in the

mandatory savings account to yield interest and build the much needed reserve required for meeting group financial obligations.

HOW FLEXIBILITY IN THE SAVINGS INSTRUMENT, AND PART DISBURSMENT OF LOANS CAN ENHANCE THE LINKAGE PROGRAM.

Assume that a self-help group mobilizes financial resources Y in a month from which she spends X on operations of the group. The group ordinarily make savings when $Y > X$. If the group enlists in the Linkage Program and commences the mandatory savings, M, the financial obligation of the group now increases to include the mandatory savings such that $Y = X + M$1

On disbursing loans, L, to benefiting members of the group, the financial obligation of the group further increases to include periodic repayment of the principal, P and the interest, iP. Hence $Y = X + M + P + iP$ 2

At this point the group has to mobilize enough resources such that the savings mobilized Y is sufficient for X, M, P, and iP. Invariably, the group financial obligations are fulfilled whenever $Y = X + M + P + iP$.

If $Y < (X + M + P + iP)$ in any particular month, meeting the monthly financial obligations becomes difficult. According to the design of the linkage, the mandatory savings M earns interest, iM but the groups have no access to this savings and interest until all loans are repaid. Consequently, the mandatory savings component M in the equation increases by an amount iM ie $M + iM$.

If the linkage now give a portion of the loan, L, say, C, to some of the group members while others wait for previous beneficiaries to repay, such that $L - C = h$ is deposited in the group savings account to earn interest, ih, then the mandatory savings component becomes $M + iM + h + ih$. This implies that the financial obligation of the group reduces

since only a portion of the principal Cp and its interest Ci will be paid. Invariably, $Cp + Ci < P + Pi$. This will make the equation of group financial obligation to be $Y = X + [M + (iM + h + ih)] + Cp + Ci$ 3

Again if the Linkage allows groups to save more than N100.00 [one hundred Naira] per beneficiary and allows the group access to the group's savings account at least up to a level, groups will be encouraged to deposit excess liquidity in the group savings account. If we call the excess liquidity E and its interest iE, then the mandatory savings now becomes: $M + iM + h + ih + E + iE$. We now re-write equation 3 as follows:

$$Y = X + [M + (iM + h + ih + E + iE)] + Cp + Ci$$

.....4

If the linkage now relaxes emphasis on the mandatory savings in favor of loan repayment such that the groups are allowed access to the mandatory savings account at least up to the amount in default, T, for any particular month, then T will go to strengthen Y whenever it falls short of the amount required for legitimate group activities, X, and loan repayment obligations, Cp + Ci, of the linkage program. Invariably, equation 4 becomes:

$$Y + T = X + [M + (iM + h + ih + E + iE - T)] + Cp + Ci$$

.....6

At the time when $Cp + Ci = 0$, the other members of the group receive h leaving hi in the group savings account to earn interest, hiN At that time equation 6 becomes

$$Y = X + [M + (iM + hi + hiN + E + Ei)] + hp + hr$$

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(Where hp is the principal repaid and hr is the interest.)

At $hp + hr = 0$, the proceeds of the savings component remain to strengthen the group's capacity for financial intermediation.

CONCLUSION.

The financial linkage of self-help groups

with banks was introduced under the Agricultural Credit Guarantee Fund Scheme as a means of ensuring satisfactory levels of loan recovery. Unfortunately, the design and operation of the linkage stifles the ability of groups to repay loans, but instead emphasizes

building satisfactory levels of mandatory savings by groups to serve as collateral for the banks. In itself, the existing design of the mandatory savings is only 62% effective in mobilizing savings and groups are generally effective in making the mandatory savings when they have not obtained loans.

Allowing the groups access to the mandatory savings is an important factor, which can turn around the fortune of the linkage model. In fact, if groups with uncorrelated project choice are fostered and measures that encourage joint liability of groups adopted, flexibility of the savings instrument will assist groups to fulfill repayment obligations at periods of adversities and thus enhance the performance of the linkage.

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