

PN-ABW-645  
815722

Economics and Sociology  
Occasional Paper No. 2025

**FINANCIAL INTERMEDIATION BY NGOs:  
IMPLICATIONS FOR INDIGENOUS VILLAGE GROUPS  
IN THE GAMBIA**

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January 1993

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## **Abstract**

This paper reports on the implications of financial intermediation by NGOs for the functions performed by indigenous self-help village groups in The Gambia. The entrance of NGOs into villages appears to represent only a partial substitute of financial services for the insurance functions traditionally performed by indigenous village groups.

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Recently, economists have begun to look into several village level institutions in low income countries to understand the micro and macro environments that explain their existence and mode of operation (Alderman and Paxson; Townsend). A better understanding is required of how and why traditional village institutions function in order to anticipate the implications of introducing new village institutions to resolve economic and social problems. The need is particularly important in those countries where non-governmental organizations (NGOs), frequently linked to international agencies, are rapidly expanding their scale and scope of operations. This paper adds to emerging literature on traditional village institutions by examining the impact of NGO expansion on indigenous village groups in The Gambia.

Subsaharan African (SSA) countries report a variety of indigenous village level mutual help informal groups. In The Gambia such groups are called kafos and they provide insurance against idiosyncratic and aggregate risks and uncertainties (Carney; Shipton).<sup>1</sup>

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\* We acknowledge with appreciation the assistance we received in conducting this research from the USAID Mission in Banjul, from the farmer's groups in the survey villages, and from our colleagues Douglas H. Graham and Dale W Adams. The usual disclaimers apply.

<sup>1</sup> Kafo is a Mandinka word that roughly corresponds to yirde or compin in Fula and morom in Wolof (Shipton).

The kafos are multifunctional, endogenous (voluntary) and usually homogenous in terms of members' age, ethnicity, gender and occupation but have various membership sizes. Indeed, these multifunctional endogenous kafos are a response to imperfect and nonexistent markets in rural areas. The kafos extend insurance through several substitutes that include informal savings and contingency credit activities, and social relationships that ensure mutual help. Recently, there has been an emergence of NGOs as financial intermediaries in the rural Gambia and several of them channel loan funds through kafos (Graham et al.,).<sup>2</sup> The NGOs, however, tend to offer only a single service compared to the multiple services provided by traditional kafos. Therefore, the entry of NGOs into the financial markets and their use of kafos as conduits for loan programs may cause a shift in importance within and across the functions performed by the traditional kafos. While the provision of financial services may partly shift from the traditional kafos to NGOs, the kafos may still exist to perform several other important village functions. As a result, institutional duality may emerge through the coexistence of NGOs and kafos in the same village.

The emergence of NGOs as financial intermediaries can provide an efficient alternative financial system to the villagers in a country where formal financial institutions provide few services in rural areas. The use of kafos for directing financial services can

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<sup>2</sup> It has been argued that targeting groups rather than individuals shifts two costs from the financial intermediaries to the borrowers: (i) borrower screening costs, and (ii) monitoring costs thus reducing transaction costs and repayment problems (Besley; Stiglitz; Varian). Empirical evidence from developing countries, however, show mixed results in loan repayment performance where the groups have been used (Huppi and Feder).

improve loan repayment rates and reduce transaction costs in mobilizing savings.<sup>3</sup> These developments, however, can be counterproductive by reorienting traditional functions of kafos and creating negative externalities through the deterioration of traditional insurance mechanisms useful to marginal populations. The net effect of the NGOs' emergence as financial intermediaries in rural areas, therefore, depends on two factors: (i) the primary reason for the existence of kafos: demand for insurance against idiosyncratic risks rather than community oriented activities; and (ii) the substitutability of the type of services provided by the traditional kafos and by NGOs. It can be posited that the NGOs diminish or displace the traditional kafos if insurance objectives were the primary reason for the existence of kafos and if financial markets are perfect substitutes for contingency markets. Otherwise, institutional duality will occur with the coexistence of kafos and NGOs providing the services demanded by villagers.

This paper reports on an attempt to examine the implications of financial intermediation by NGOs on the functions performed by kafos based on a random survey of 20 villages in The Gambia. The functions of several kafos are influenced by the introduction of NGOs into these villages. Therefore, this paper first traces the evolution of kafos to understand their traditional functions. This is followed by a discussion of the functions of kafos in the sample villages. Policy implications conclude the paper.

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<sup>3</sup> The rural households, especially women engaged in vegetable farming, often save in small quantities in frequent intervals (Shiptor.). The transaction costs involved in mobilizing these small but frequent funds on an individual basis are often high for financial intermediaries. A group of savers can, however, collectively deposit a larger amount and thus reduce transaction costs.

## II. Evolution of Kafos

The evolution of kafos from simple age based self-help groups to complex social and economic institutions is influenced by several micro processes that shape their formation and macro processes that facilitate their metamorphosis as economic institutions in rural villages. The emergence of modern kafos can, therefore, be explained through variations in these micro and macro processes.

It is not clear when kafos originated in the Gambia. It can be postulated, however, that kafos were formed in the early sixteenth century in areas currently called The Gambia when the majority of tribes found there migrated from Mali. The presence of indigenous village groups similar to kafos called demisenu tons are documented in Mali as early as the late fifteenth century (Hopkins). Historically, the word kafo referred to groups of individuals that belong to particular age groups within a ward or a village.<sup>4</sup> The kafos were primarily involved in implementing self-help public works projects for the community such as village cleaning, well digging, building houses and, to a lesser extent, the cultivation of crops for households with insufficient family labor.<sup>5</sup> Providing labor to the kafo was mandatory and failure to do so was punishable by fine or by threat of physical force. The kafo members also participated in organizing social and political activities within the village (Weil).

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<sup>4</sup> While kafos of individuals aged above forty five years functioned as an elite council that formulated rules for the community, the kafos of individuals between the ages of twenty to forty five were often responsible for the provision of labor services.

<sup>5</sup> The kafos that provided labor services to individual farmers were compensated through the provision of food and drinks (Hopkins).

With the shift from subsistence to a more commercialized agriculture through the introduction of cash crops like groundnuts that required a large and constant flow of labor, and with the lack of organized labor markets, the kafos began to also function as labor rotation groups. In these groups, the members rotated labor among their plots and hired out labor to families with insufficient labor in adjacent villages. At this point the criteria for membership expanded to include both age and occupation. The kafos functioned as convenient mechanisms to organize labor on a mutual help basis and also increased the bargaining power of hired labor, especially in rice growing areas (Carney). While it is difficult to chronologically identify the period when these labor rotation groups also began to undertake insurance and financial services, it can be speculated to be a logical response to the commercialization of agriculture. The shift to more commercialized crops had three effects: (i) it reduced the food crop area that provided food security to the households,<sup>6</sup> (ii) it increased the cash flow due to the sale of crops, and (iii) it led to the formation of commercialized labor groups that were no longer available to provide free labor services. While the commercial crops were often characterized by high yields, they were also prone to exogenous shocks that led to a high variance in yields. However, formal insurance markets did not exist to insure against idiosyncratic risks and provide food security by consumption smoothing. Furthermore, there were few formal financial mechanisms to mobilize the savings that accrued due to commercialization, and to provide contingency

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<sup>6</sup> See Van Braun for the role of crop diversification on the food security of farm households in The Gambia.

credit to cover individual contingencies. Therefore, the kafos began to embrace the functions of insurance and financial markets with their other functions.

The modern kafos, while maintaining some of their historical characteristics, have evolved into multifunctional informal groups with multiple criteria for member eligibility in addition to age. The term kafo has become a generic term to represent the majority of group activities undertaken in a village. Several authors have documented kafos as versatile and complex village level institutions in The Gambia (Carney; Shipton). While the kafos are well established institutions, several variations have been observed among the kafos in terms of their functions as a result of the microenvironment in a given village. The next section highlights some of the variations in kafo functions that have emerged as a result of the differences found among villages.

### **III. Empirical Evidence about the Functions of Kafos**

The objective of this research was to examine the functions of traditional village self-help groups in the Gambia and the implications of the emergence of financial intermediation by NGOs. The NGOs emerged as financial intermediaries in the late eighties and there are a total of 14 NGOs that offer financial services in more than 500 rural and peri-urban villages, and several of them use kafos as conduits for loan programs (Graham et al.). Therefore, we selected for field study a total of 20 NGO and non-NGO villages at random from several geographic locations. Information was gathered through interviews designed to collect data on the functions of kafos in the sample villages during April 1992. None of the sample villages was serviced by any formal financial institution,

although 6 of them were eligible for production credit from the Gambia Cooperative Union. The majority of the sample villages were serviced by several NGOs. Two international NGOs, Action Aid and CIDR, were the major financial intermediaries. While Action Aid provided loans to individual members and indigenous kafos in eight of the villages, the CIDR assisted in the formation of village banks called Village Savings and Credit Associations (VISACAs) in five sample villages and encouraged village kafos to participate in these savings programs.<sup>7</sup> Whereas the majority of NGOs supply loans only for production purposes, the VISACAs do not target any specific loan purposes.

Of the 20 sample villages, 18 reported the existence of kafos. While 7 of the villages with kafos were not assisted by NGOs, 11 of them were assisted by either one or a combination of NGOs and VISACAs. The VISACAs encouraged kafa membership in 4 of the sample villages, and the NGOs directly used kafos from 8 of the sample villages as conduits for their loans to individuals (Table 1).

The survey revealed that the kafos were usually homogenous in member characteristics including age, gender, ethnicity and occupation. Furthermore, the kafos were more frequently found among farming than among non-farming households. They performed economic activities that included the provision of insurance, credit and savings mechanisms, and social and political activities. The kafos were broadly classified into four groups based on their primary functions.<sup>8</sup>

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<sup>7</sup> See Graham et al., for details on several NGO programs and VISACAs in The Gambia.

<sup>8</sup> Since the functions were usually overlapping, the classification is not mutually exclusive as the observations lie along a continuum.

a. Insurance kafos: In general, members (women, men or both) cultivated a common plot of groundnuts, cereals or vegetables and contributed the sale proceeds to a common village fund primarily used to mitigate village level contingencies and, to a lesser extent, member contingencies. The terms and conditions for contingency loans varied based on the composition of members and the fund size of a given kafo. Some kafos, especially the large ones, allocated a certain amount of the proceeds for village level contingencies and divided the rest among themselves instead of supplying member loans.<sup>9</sup>

b. Savings and credit kafos: These kafos undertook savings and credit activities on an organized basis. Savings were mobilized through regular contributions to the savings fund that was usually nonrotating in nature and were divided among the members at the end of a specified time (ex. ramadan feast). While no interest was paid on funds maintained within the village, the kafo funds deposited in VISACAs and commercial banks earned interest. The kafo funds were accumulated through cultivating a common field, deposits mobilized and interest earnings from previous loans. Considering the labor contributed to common fields as a type of membership fee, the design of these savings and credit kafos resembles that of rudimentary credit unions. Loans to kafo members to meet contingency needs were usually supplied from kafo funds at a group determined interest rate. Penalties for non-repayment of loans included social sanctions against the family of the borrower.

c. Labor kafos: These were mutual aid kafos primarily organized to mobilize labor during peak demand. The labor usually rotated among the members to take advantage of

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<sup>9</sup> This is a rational behavior since the size of a group is inversely proportional to the familiarity and linkages among its members. Therefore, the informational and peer monitoring advantages of group related activities declines with increase in group size.

seasonal variations and water availability on specific plots. Some labor kafos also performed insurance functions for their members by supplying contingency loans from kafo funds. The kafo funds were accumulated through the cultivation of a common plot.

d. Social and political kafos: These kafos were transient in nature and were usually used to organize social activities (ex. soccer club) or political rallies. While they collected contributions (one-time/periodic) from their members to cover their costs, they were not directly involved in credit and savings activities.

Based on the above classification, the primary and secondary functions of the kafos found in the sample villages are presented in Table 2. One important observation is that the traditional kafos did not disappear with the entry of NGOs into the villages but coexisted with them and performed various non-insurance activities. Kafos not assisted by NGOs primarily provided insurance against idiosyncratic risks through contingency credit to their members. In contrast, kafos assisted by NGOs functioned primarily as mechanisms for group savings and credit activities, as collateral substitutes for group lending activities and as institutions for organizing social and political activities. The preponderance of credit and savings kafos in NGO villages can be attributed to two factors: (i) the NGOs prefer to supply loans to groups rather than to individuals, and (ii) since the majority of NGOs do not supply contingency loans, the kafos evolve into rudimentary credit unions to fill that gap. It is also interesting to note that while kafos that are assisted only by NGOs still perform insurance functions, the kafos assisted by only VISACAs do not. This is probably due to the untargeted loans of the VISACAs which can be used for consumption smoothing thereby substituting for the traditional kafo insurance mechanisms.

Table 3 demonstrates shifts within and across the functions performed by the kafos associated with the emergence of NGOs and VISACAs in the sample villages. The observations show that kafos in non NGO villages (group I) perform several functions including financial intermediation. Whereas kafos primarily provided insurance and financial services in non-NGO villages (group I), the NGOs and VISACAs partially substituted for the kafos in providing these services in NGO villages (groups II and III). This in part induced a shift across the primary kafo functions from insurance services to social activities. However, the intervention of NGOs caused a shift within the financial services provided by the kafos. While the kafos traditionally provided emergency loans to meet any purpose - consumption or production - the majority of NGOs targeted production purposes. Therefore, in addition to the financial services provided by the NGOs, the kafos still needed to provide financial services through the provision of contingency credit and insurance. This point is demonstrated by two observations: (i) the kafos still provide insurance services in both group II and III villages, and (ii) the kafos and NGOs jointly provide loan services in group II villages and NGOs provide loan services in group III villages. However, kafos that were assisted by VISACAs in group II villages tended to shift their functions from insurance and financial intermediation to social and political activities. This underscores the importance of untargeted credit that can be used for consumption smoothing as an insurance substitute in rural areas.

The above observations suggest that when NGOs enter villages insurance functions are partly shifted from kafos to the NGOs. But they are not perfect substitutes as indicated by the coexistence of kafos with NGOs in providing financial services. These results also

indicate that kafos are not formed merely to function as insurance substitutes but to perform other activities as well. However, the entry of NGOs into these villages has caused a shift within and across the functions conventionally performed by kafos in rural areas. It is not clear if marginal populations in the village are effectively served by either the transformed kafos or NGOs. Whereas the traditional kafos had an explicit village welfare objective, the NGOs and VISACAs are trying to develop local institutions with more of a business approach to savings and credit. Villagers with larger assets may find they are better served by NGOs and VISACAs. But the marginal population may be rationed out of these NGO activities.

## **V. Conclusions and Policy Implications**

The NGOs have expanded rapidly in many SSA countries and many are providing financial services. The expansion of NGOs into rural areas may have implications for traditional village self-help groups. This study attempted to address this issue. The results showed that the entry of NGOs, especially the VISACAs, into the villages studied represents a partial substitution of financial services for insurance functions performed by kafos. Since NGOs generally targeted their loans for production purposes only, the kafos were still needed to provide contingency credit and insurance.

An unanswered question concerns the distribution of access to financial services. The traditional kafos performed multiple functions including insurance and financial services, but the NGOs limit their functions only to financial services for specific purposes. This study could not collect data from individual villagers, so there is no way of knowing how access

to financial services may have improved or worsened for various groups within the village as NGOs and VISACAs attempt to introduce a more businesslike attitude into production lending. It is possible that NGOs will move away from consumption or contingency lending. If this occurs, poorer members of the village may find that the demise of the traditional kafos may spell the end for their access to traditional village contingency and welfare funds. Furthermore, some NGOs and VISACAs may adopt policies of channelling earnings and surpluses back to individual members rather than use them for village-wide purposes. Therefore, if kafos do not continue to coexist alongside the NGOs, it is possible that some villagers will no longer be insured against idiosyncratic and aggregate risks.

Furthermore, there is another issue that falls outside the scope of this research but is relevant for a more comprehensive analysis of the implications of greater financial intermediation by NGOs. This concerns the use of kafos as conduits by NGOs. On the one hand, kafos may reduce transaction costs, improve savings mobilization and reduce loan repayment problems through peer pressure. On the other hand, moral hazard problems can be introduced into the kafos if external funds rather than locally mobilized savings are used by NGOs for lending and if kafos are poorly monitored and are not provided with incentive compatible contracts. The problem of poor loan recovery that has plagued formal financial institutions in SSA could then begin to contaminate informal financial arrangements to the jeopardy of traditional village institutions.

Table 1. Number of Sample Villages, by Presence of Kafos and NGOs.

Item		Number
I.	Sample Villages	20
II.	Villages with no kafos	2
	Villages assisted by NGOs and VISACAs	1
III.	Villages with Kafos	18
	Villages assisted by NGOs and VISACAs	4
	Villages assisted by NGOs only	6
	Villages assisted by VISACAs only	1
	Villages with No NGOs and VISACAs	7
IV.	Villages where Kafos are Used by NGOs and VISACAs as conduits	8

Table 2. Primary and Secondary Functions of Kafos in Sample Villages, by Presence of NGOs <sup>a</sup>.

Items	Primary Function <sup>b</sup>				Secondary Function <sup>b</sup>			
	I <sup>c</sup>	C&S <sup>c</sup>	L <sup>c</sup>	S&P <sup>c</sup>	I <sup>c</sup>	C&S <sup>c</sup>	L <sup>c</sup>	S&P <sup>c</sup>
	(Number of kafos under each category)							
I. NGOs and VISACAs are absent	5	1	0	1	0	2	2	0
II. NGOs exist and use Kafos as conduits	2	6	0	0	1	2	2	1
a. VISACA + NGO	0	3	0	0	1	1	1	0
b. NGO only	2	2	0	0	0	1	1	0
c. VISACA only	0	1	0	0	0	0	0	1
III. NGOs exist but do not use Kafos as conduits	1	0	0	2	0	0	0	0
a. VISACA + NGO	0	0	0	0	0	0	0	0
b. NGO only	1	0	0	2	0	0	0	0
c. VISACA only	0	0	0	0	0	0	0	0

<sup>a</sup> The functions of only the biggest kafo in the village are considered for analysis; <sup>b</sup> The primary and secondary functions are according to the primary and secondary reasons for the existence of kafos in the sample villages; <sup>c</sup> I = Insurance; C&S: Credit and savings; L = Labor rotation; S&P: Social and political.

Table 3. Functions Performed by Kafos, NGOs and VISACAs in Sample Villages <sup>a</sup>

Villages	I <sup>b</sup>	C&S <sup>b</sup>	L <sup>b</sup>	S&P <sup>b</sup>
<b>Group I Villages. NGOs &amp; VISACAs absent</b>				
V1	Kafo	Kafo	- <sup>c</sup>	-
V2	Kafo	Kafo	-	-
V3	Kafo	Kafo	-	-
V4	Kafo	-	-	-
V5	Kafo	-	-	-
V6	-	-	Kafo	-
V7	-	-	Kafo	Kafo
V8	-	-	-	-
<b>Group II Villages. NGOs &amp; VISACAs present and use kafos as conduits</b>				
V9	Kafo	NGO/Kafo <sup>d</sup>	-	-
V10	Kafo	NGO/Kafo	-	-
V11	Kafo	NGO/Kafo	Kafo	-
V12	-	NGO/VISACA <sup>e</sup>	-	-
V13	-	NGO/VISACA	-	Kafo
V14	-	NGO/VISACA	Kafo	-
V15	-	NGO/VISACA	-	-
V16	-	NGC/Kafo	-	-
<b>Group III Villages. NGOs &amp; VISACAs present but do not use kafos as conduits</b>				
V17	Kafo	NGO <sup>e</sup>	-	Kafo
V18	Kafo	NGO	-	-
V19	-	VISACA <sup>e</sup>	-	Kafo
V20	Kafo	NGO	-	-

a Both primary and secondary functions are considered.

b I = Insurance; C&S = Credit and Savings; L = Labor; S&P = Social and political.

c A dash implies that the functions are performed by neither kafo nor NGO.

d NGO/Kafo implies that the kafos are used as conduits by the NGOs. In addition, kafos provide some financial services.

e NGO/VISACA implies that financial services are provided by NGOs and VISACAs only. Kafos are neither used as conduits nor provide these services on their own.

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