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SAVINGS AND CREDIT ARRANGEMENTS IN THE INFORMAL FINANCIAL MARKET OF DEVELOPING COUNTRIES: OBSERVATIONS FROM SRI LANKA

By

F. J. A. Bouman
Sociologist
Agricultural University
Wageningen

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Paper reviews the different forms of informal credit and savings activities in rural areas of Sri Lanka. It is argued that substantial amounts of savings are mobilized in these informal systems. The advantages of informal lending are also stressed.

There is a growing consensus among researchers that the institutional finance sector (government, banks, cooperatives) is unsuited to cope with the needs of the greater part of the rural populace in the third world (Adams and Graham). The view that the poor in society constitute financial basket cases does not inspire policy makers to search for challenging new concepts and procedures to accommodate them (Von Pischke). This raises the question of how the poor manage their financial affairs.

Partially, the answer lies in self help. Through a long tradition people have devised mutual aid formulas to satisfy their savings and credit needs. They also turn to pawnbrokers, shopkeepers, moneylenders and the like. Surprisingly, this much abused class of informal financial intermediaries appears to play important roles in self help institutions.

This paper is about informal saving and credit in developing countries with special reference to Sri Lanka. It is exploratory and deals mainly with self help type actions. Apart from recording personal observations, the paper draws on material gathered by four graduate students who each spent six months

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* F. J. A. Bouman is a sociologist in the Agricultural University, Wageningen, Netherlands.

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in the island. M. Overheul and B. Burgers studied the cheetu, a rotating savings and credit association that is popular throughout the world under various names. M. Boot and J. Vel, living in a tiny village in the mountainous Kandy district in the island's centre, studied the savings, credit and investment behaviour of individual families. Discussing daily financial worries with women, they provided a female point of view, so often unaccessible to the male observer.

Why, how and with whom people save

Policymakers and development planners in the third world need not worry about designing projects to enhance the spirit of thrift. Reports from different parts of the globe refute the myth that poor people cannot and do not save. They deposit money with church groups, dance societies, rotating savings and credit associations (ROSCA), cultural groups and age sets as reported by Miracle. They save with finance companies, Christmas clubs, tax payment groups, pilgrimmage funds and death aid societies; or they entrust their savings to individuals noted for their financial expertise such as mobile bankers, pawnshopkeepers, traders and moneylenders like the Chettiars in South East Asia (Weerasoria).

Thrift comes naturally to households that have to cope with irregular income flows. Rural families in Sri Lanka, particularly in the lower income brackets, show an almost passionate desire to save in one form or another. Boot reported how a family abstained from using curries with ricemeals in an effort to save for an urgent, out-of-village trip. Children at the age of seven or less are taught the virtues of frugal living by encouraging them to contribute part of their daily ration of school biscuits to a savings fund rather than eat them. At a recent rural finance seminar for village workers of Sarvodaya - a well-known rural development movement in Sri Lanka - participants reported remarkably high savings levels. Of the 41 participants, 25 were males and 16 females, all in the age group of 21 to 35 years. The average monthly income of the men was Rps 434 (US $20) with no great variations among salaries. There were only five non-savers amongst them, of which four were unmarried. The remaining twenty reported average savings of Rps 112/month, equivalent to 26 percent of their income. The savings rate increased inversely with salary: the lower the wages, the higher the relative savings rate. The women averaged a monthly income of Rps 340 (US $17) and recorded a savings rate of 21 percent. Similar high savings levels have been reported elsewhere in the third world (Bouman, 1979).

Savings may be held in cash, in goods or in debt claims. Women with little or no access to cash earnings have become very adroit in designing savings tactics in daily householding. They save in foodstuffs, keeping spoonfuls of rice or sugar apart from the daily meal. The weekly treasure may be stored, converted into cash or contributed to a cheetu fund. At the time when jackfruit is plentiful and nearly free, it is cooked, dried and stored to provide cheap meals later in the year. Food is often hoarded for months in preparation for an expensive event such as the Sinhalese New Year, a wedding ceremony or the coming of age of a daughter. The matweavers in Vel's village habitually saved some cane, the material most important to their craft. At a time when they themselves cannot practice their trade (because of illness or employment elsewhere) they give this cane to another villager on the basis of a shareweaving contract that divides the proceeds of the sale of the mats between them.

An illustration of saving through debt claims is the labourer who asks his employer to postpone payment of wages until some future date, or the farmer who prefers that the buyer of his produce defers payment until delivery of the last crop. The most telling example, however, is that of Boot's own landlady, who asked her lodger not to pay for board and lodging until the last day of lodging. Every now and then this landlady used to borrow a few rupees from her guest. But she took great pains to repay these 'loans' within a few days, anxious as she was to preserve the debt claim that was gradually building up. In all these instances, income is deferred. Rather than receive small amounts now, creditors prefer payment of a lump sum at a later date. Debt claims also get around the problem of finding a proper depository, a problem that is likely to worry many savers.

People save for a variety of reasons. When we deal with rural households which generally face irregular income flows (agriculture being a seasonal business) a prime concern is to regulate flows of receipts and expenditures in a way to strike a balance. Saving and borrowing are merely tools of this balancing process. As in keeping debt claims alive in order to defer income for an uncertain future, one may delay payment of debts to a more convenient date when extra income is more likely. In this sense, saving and borrowing are aspects of risk management behaviour. People like to have working balances on hand for the sake of convenience, to meet unexpected expenditures and for protection in times of hardship (Von Pischke). There are households where women keep a bit of rice or money handy for passing to beggars. Others even borrow to preserve wealth. This is best demonstrated by the habit of borrowing money to buy rice cheaply now, rather than depleting stores and being forced to buy higher priced rice later.

Disposition of savings includes productive investment, consumption and social welfare, e.g. old age security, expenses connected with rites of passage, religious festivals, and enhancement of status. It is commonly held that poor people principally use savings for consumption and social welfare, while high-income earners can more easily afford to invest part of their funds in productive factors to increase income and hence future consumption. Are the poor, then, not interested in improving their economic and financial position? Of course they are. But the low and irregular income earners are more sensitive to risk as they have problems enough to keep consumption levels above starvation. Also, especially when living in a tiny community, they are acutely aware of that community's norms of what constitutes prudent and wise husbandry and what will be regarded as plain avarice. Storing food for years for a social ceremony or a wedding is acceptable. But saving large amounts for an investment and future riches while letting others go hungry causes jealousy and harsh criticism. Indivisibility of investments and commodities presents particular problems for low-income earners. To buy a tractor, a cow, a sewing machine, or to build a house or dig a well for irrigation requires a considerable outlay of cash, and hence a long gestation period in which funds have to be stashed away safely and not too openly. This has consequences for human savings behaviour. Particularly relevant is the question whether one ought to save individually or in groups, and whether to keep one's savings at home or deposit them with a trustee.

Most people start to save individually, at home. But as funds accumulate and become more voluminous, the temptation to sacrifice part of the savings for the ever pressing daily needs grows. Likewise grows the fear of theft and of the claims of prying relatives to have access to part of the idle goods and funds. Now the illiquidity preference becomes stronger than the desire to have liquid balances on hand for the sake of convenience. Having too large a treasure in the house is no longer convenient. Savers who want to continue the savings-process because the acquired sum is not yet sufficient for the intended investment have to change their tactics. Several options are open. Food, goods and money may be converted into silver, gold, or ornaments. In the case of women, ornaments are commonly regarded as personal property that cannot lightly be claimed even by relatives. A villager once remarked to Boot that "a women without ornaments if like a women without a background - without a family to protect her." Gold and silver have the additional advantage of a hedge against inflation; and can easily be converted back into money, if necessary; they also enhance status; and they may be pawned as loan security.

The saver may also decide to hold his funds in the custody of someone trusted. This could be one of the institutional agents: bank, cooperative, postal office or credit union. However, the rural poor rarely feel inclined to approach and confide in an insitution with which they normally have few or no dealings. Despite attractive interest rates - commercial banks in Sri Lanka offered rural depositors interest rates between 14 and 22 percent in 1980 - there still is a preference for traditional custodians: the shopkeeper, pawnbroker, merchant and moneylender, the village priest, a teacher or someone of equally high status. The cautious saver will spread his savings over a number of different trustees. Una Lele reports how the Punjabi cultivator customarily deposits returns from the sale of farm produce with his commission agent as a matter of safety and convenience. In Sri Lanka the Chettiar used to perform the same role. These deposits seldom carry any interest. The loss of a savings' reward is felt to be compensated for by factors like easy access, prompt service, lack of procedural pomp and the almost certain knowledge that the deposit of one's savings entitles the depositor to a line of credit when in need. I believe that probably the most important aspect of these arrangements is that a savings deposit here is equal to credit opportunity. By saving with a group or with persons of a firm financial standing, the saver buys security. A regular deposit of money establishes a reputation of creditworthiness and the right to immediate access to a loan in an emergency.

Group arrangements for saving and borrowing

Savings clubs have a number of advantages over saving individually. The saver sheds awkward liquidity, thus avoiding embarrassing claims of relatives and friends. The club is also a safe depository; the cases where a treasurer absconds with the money, are rare. Further, a group enhances discipline, notably so with contractual savings, when participants have agreed to a regular and fixed contribution. Members of a cheetu frequently state that they prefer one of the end positions in the rotation cycle simply to be forced to continue the savings process. Miracle reports that informal savings associations in Africa, through joint action, provide members a variety of economic benefits like a discount on bulk purchases or the exchange of economic and market intelligence when traders and similar businessmen band together.

Illustrative examples of this in Sri Lanka are the commodity cheetu and the pilgrimmage society. In a commodity or 'article' cheetu, members make regular, equal deposits to a fund from which each, in turn, will receive the agreed article (a system resembling installment buying). Members may benefit from a price reduction by placing a joint order with a store. Although still popular, commodity cheetu have experienced difficulties because of inflation. After the first few rounds, prices go up so much that the fund is no longer sufficient to accommodate the last few participants. Usually the lucky early receivers are reluctant to increase their contribution (the logical solution) to compensate late receivers, arguing that it is all in the game. The eventual discontent can result in a (temporary ?) decrease in popularity of commodity cheetu.

Pilgrimmage societies are another case in question. It is customary for Sri Lankans to visit one of the holy places like Anaradhapura or Polonnaruwa during one of the religious festivals. By making the journey together, members of a pilgrimmage society can bring down the costs of lodgings and bus fare. But, inflation can again catch participants by surprise. In one particular case that I came across, 42 members of a club tried to raise a sum of Rps 135 each by depositing Rps 15 monthly during nine months with the female organizer, who acted as tour operator. This woman meanwhile used the accumulated savings to finance her private business affairs. At the end of the nine months, however, she refunded each member his deposits, stating that the tour was off because bus fares had gone up on account of rising petrol prices.

Mutual aid is at the core of numerous group savings schemes. In Asia the village rice bank is a famous example. Participating households contribute rice to a common stock from which loans in kind are made to needy members. After harvest, stocks are replenished again. Rice banks are found in Indonesia, India (see Bailey) and Korea (see Kennedy), while in Sri Lanka the rice cheetu is a somewhat adapted form. Mutual aid frequently becomes the equivalent of an insurance policy. A protective fund is accumulated to insure members against the high expenses connected with rites of passage like a birth, coming of age, and a wedding or funeral. The most common example is the death aid society that is found even in the poorest and most destitute regions of Sri Lanka. There are two types of such societies, one that collects funds only when a death occurs and another where regular contributions are solicited. The latter type is the more interesting, because some of these societies do not stop at merely accumulating funds which are left idle between burials. In a community where capital is scarce, this would be a waste of valuable resources.

In Poddala, a village in the south of Sri Lanka, the monthly fund of the local society used to be partly utilized to buy ceremonial paraphernalia which were loaned free of charge to needy members.[2] But assistance was also given in cases of hospitalization, birth and home improvement, and the society even operated its own home for the aged. Because this welfare-cum-death aid society had clearly over extended itself financially, it shed most of its welfare functions in 1980 and reverted to a purer form of burial society.

In other villages, accumulated funds have become loanable. Burgers in Kurunegalla and Overheul in Kengalla (Kandy district) noted that burial

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2/ A village may have separate societies for the rich and the poor (caste differences may also decide membership). Ginimellegaha, another southern village, with only 500 families, nevertheless, has three different burial societies.

societies lend money to members for short periods. The one in Kengalla had a select membership of 30 and maintained strict, written rules. Meetings were held weekly and personal attendance was obligatory. Loans were given against collateral only, members paying ten percent interest per month, while non-members had to pay twelve percent. Interest income is added to the fund. This burial society had gradually, maybe even unintentionally, taken upon itself a lending function when the opportunity to do so arose.

There are in Sri Lanka numberous other, more loosely structured, non-community oriented organizations that have safekeeping and lending as their primary aim. They clearly indicate that people do have a genuine savings need apart from the demand for credit that is so often emphasized in the literature.

Samagan, polipettye and petty kasi[3/] are but regional names for one and the same thing in different districts. The principal arrangement in all these group schemes is that a participant turns over his savings at regular intervals to a treasurer (organizer) for safekeeping. After a certain period, usually one year, a lump sum is returned that may or may not include a reward in the form of interest. The organizer often uses the savings as working capital for his own business affairs, but is also expected to make loans to members and usually to nonmembers as well, who generally pay higher interest rates. Schemes often end with the Sinhalese New Year when households face extra expenses for food and clothing.

A samagan in Binkome, a settlement colony in the south, has 22 members, each contributing Rps 10 monthly. Members may take out a loan without paying interest, provided repayment is made within one month. For a longer term loan

3/ Samagan literally means company; poli = interest and pettye = box.

(the maximum period is 11 months) they have to pay 10 percent per month, while nonmembers pay 20 percent. At the end of one year all savings are returned and the dividends distributed. Those who took out a loan receive half as much dividend as the members who did not. There is a limit on total loans, which may never exceed fifty percent of the accumulated savings. The organizer frankly admitted that he organized this samagan to acquire working capital for his trading business. Note the built-in devices to safeguard his interest, viz the 50 percent loan to deposit limit and the disincentive for members to borrow by restricting their dividend claim.

In general, people judge their informal institutions superior to the bank, where "it is impossible to get an immediate loan in times of need." The informal high interest rates are not considered excessive. In fact, some members take out a loan at 10 percent to pass it on at 20 percent to others. Moneylending has become a very normal facet of daily village life.

The Cheetu

The cheetu is a rotating savings and credit association (ROSCA) and by far the most popular type of informal financial institution in the country. The ROSCA appears under different names in all parts of the world and hence has received much attention in the literature. Because its functions, techniques and procedures have been extensively reported elsewhere (Bouman 1979), I will only highlight those features that are peculiar to the Sri Lankan situation.

The basic formula is very simple. A ROSCA consists of a group of participants who make regular contributions to a fund which is given to each member in turn. When twelve individuals contribute Rps 25 each in a monthly cheetu, each of them will eventually receive a sum of 12 x 25 = Rps 300. After twelve months the affair is completed, each player has had his turn and the cheetu will disband or start a new cycle. There may be more or fewer players the next time, shorter (e.g. weekly) intervals instead of monthly, and contributions may be higher or lower than Rps 25. The ROSCA is primarily a savings device. Members greatly appreciate the discipline of contractual group-savings, by which they gradually accumulate a lump sum via small contributions. An extra attraction is that one has access to this sum at an earlier date than when saving individually. Imagine that all participants in the above cheetu are saving for a radio that costs Rps 300. Saving in a solitary fashion Rps 25 per month, a person can expect to buy his radio in the 12th month only. In this cheetu, however, eleven of the twelve participants will realize an earlier purchase. Each one will benefit from the arrangement except the recipient of the last and final round. But he may be luckier in the next cycle because, over time, positions tend to an average.

ROSCA combine saving with lending. A member saves until he receives the fund, after which he starts to repay a loan in installments. The core element is, of course, how the rotation of the fund is regulated, because this affects the respective debtor and credit positions. The common alternatives are negotiation, lottery and auction. The choice between the three is determined by the socio-economic environment and the needs and aspirations of membership. When turns are allotted through negotiation, factors such as seniority, marital status, personal need or social position may be decisive. Compassionate or 'calamity cases' customarily enjoy priority status, while persons who are considered bad risks are put near the end of the cycle. To reach consensus calls for a high degree of homogenity and social unity amongst the group; competing claims easily result in frequent and passionate quarrels.

The lottery is, like elsewhere in the world, the most popular way to determine the sequence of rotation. In Sri Lanka today, players usually meet only once, at the beginning of a cycle, when lots are drawn. After that, the positions are known and it is left to the organizer (also called president) to collect contributions and distribute these in accordance with the result of the lottery. Of course, individuals may arrange between themselves to change places or split turns. This usually involves some payment for the privilege of receiving the fund out of turn.

In the auction cheetu the players compete with one another for the collective deposit at each meeting and thereby determine the order of rotation. Imagine twenty participants and a weekly contribution of Rps 50. Each week there is a collective deposit of Rps 1,000 for sale. By bidding, a player states the amount he is willing to forego for the sake of getting the fund at the opportune moment. A bid of Rps 200 announces that he is satisfied to collect only Rps 800 instead of Rps 1,000. If this is the highest discount offered, the Rps 200 will be divided among his fellow participants. Every player may participate in the bidding as long as he has not received the fund earlier. The only exception is the president who always gets the first fund free of discount. The amounts foregone to get the fund are interest payments that befall the others in the form of dividends. Bids may go as high as 50 percent - in this case Rps 500 - so that participants in an auction cheetu can reap handsome rewards. They do not, however, receive the full rebate. The organizer of an auction ROSCA always claims a commission, that is first deducted before the rebate is distributed. Other potential benefits that accrue to organizers are discussed later.

The rules of a cheetu vary from place to place. A successful bidder earlier in the cycle may share in the rebates in subsequent auctions which will reduce his costs; elsewhere the rebate will be shared only by the non-recipients. A 50 percent bid represents an extreme case and sensible presidents will often set a limit to the bidding, arguing that high discounts increase the potential for default. Combinations of both auctions and lottery are also possible.

Cheetu seem to change with the environment. In agricultural zones of poor or limited potential, in stagnant and backward economies and among low income groups, the lottery dominates. Auction systems make their appearance in rural areas with growth potential or with a diversified economy as exemplified in Sri Lanka by the Jaffna peninsula, the Southern wet zone and the booming vegetable producing areas in Nuera Eliya. They are also popular in towns and cities and in the circles of shopkeepers, traders, merchants and other businessmen, who use the cheetu to finance the expansion and diversification of their operations. Frequently subscribing to different funds at the same time, they find in the auction cheetu a convenient vehicle to obtain a loan that is not available through formal financial channels. Eager for instant capital without much formality, investors are ready to pay a high price, while the patient saver waits until the end, collecting a harvest of dividends. There is another element in the auction that the lottery lacks. Sri Lankans are notorious gamblers; even in remote areas I have met cultivators who bet on the horse races in England! Bidding in an auction introduces the spice of speculation and excitement. An enterprising player may pretend keen interest in the auction when his sole aim is harassing the others. The combination of eagerness for a loan and the fear of loss of prestige can certainly inflate the bidding, increase the discounts that are offered and hence the dividends that can be earned. Naturally this type of game also enhances the probability of default.

Cheetu membership and contributions

One finds traces of cheetu in every corner of Sri Lanka, and membership embraces all strata of society. Even the very poor have their own clubs with minimal deposits of one or two rupees, a handful of rice and sugar or the government-issued food coupons.4/ There are a few peculiarities, though. One is the general atmosphere of secrecy that surrounds membership. Other observers have noted this, too. Kennedy, writing about his experience in Korea, attributes this to the dubious official reputation of ROSCA which have been "journalistically" described as a hotbed of crime. This characterization had led to a noticeable defensive attitude on the part of some organizers and members. Officially, cheetu are also suspect in Sri Lanka and the government has even enacted legislation in a vain attempt at controlling them. In India, national legislation is also pending. I believe, however, that secrecy may have sources other than fear of official disapproval. Individuals appear to make an effort to hide the extent of their involvement in cheetu, even from their friends and relatives. It is obvious that they do not want to be

4/ Peculiarly, in settlement colonies (of which there are many) cheetu are rare, possibly because of lack of social unity in a group of colonists brought together from different parts of the country.

constantly harangued to share their savings with others. Even within families, membership sometimes is a closely guarded secret.

Peculiar, too, is that many informants refer to a cheetu as "a pastime for women." True enough, if one judges by numbers alone, there are more female than male members. But usually the men pay the greater part of their wives' subscriptions, while women also substitute for their husbands by having two stakes in one cheetu or subscribing to two or more clubs. The term "pastime" also is hardly appropriate. Gone are the days when ROSCA, as Geertz (1962) has put it, had a socializing function. Festive meetings, in which members discuss community and other than financial affairs, are the exception in today's Sri Lanka. Players rarely have a say in the selection of their fellow members, it is the organizer who brings the group together. In most lottery societies players meet only once to draw lots and decide the ranking order. The rest is left to the president. In auction cheetu, although members still do meet, an atmosphere of business prevails, each going his way after the auction is over. The signs of a progressive process of individualization in Sri Lankan society are also noticeable in cheetu.

Although a cheetu may number up to forty and more participants, the ideal group size is judged to lie between ten and twenty. A small group means a small fund, but faster rotation. A larger group does increase the size of the collective savings, but also the chances of failure and default. It must be difficult for people of an agricultural community, where income is seasonal and thus irregular, nevertheless, to make constant subscriptions to a savings club. Of course, deposits in kind could be acceptable and this is one reason why one encounters so many women's cheetu. In charge of the preparation of the daily food, women readily manage to withhold a spoonful of rice, flour, or sugar as contributions. Otherwise it is only the availability of off-farm income that make regular cash deposits possible. Cheetu stand a better chance to flourish in towns and cities, where employment opportunities are ample and diverse. In the rural economy, ROSCA tend to be rather small, and their success greatly depends on the skill and financial strength of the organizer.

Commissions and default

A cheetu involves little administration. Organizers carry a small notebook to keep track of both contributions and payouts. Recipients are seldom requested to provide collateral, guarantors or other forms of security. This makes the cheetu vulnerable but keeps the costs down. The important cost items in a ROSCA are commissions and default. Although both members and organizers rarely wish to discuss the extent of commissions and frequently deny its existence, most presidents receive some payment when a member collects his fund. Payments vary between two and five percent of total contributions. In one instance I came upon a novel way of extracting a commission. In a club at Illawakulam, a village near the West coast, members paid their contributions in rupees and eggs. The eggs were arbitrarily valued by the female president at a price below the going market rate and this enable her to make a profit on egg sales.

Commissions are to reward an organizer for his troubles and responsibilities. He is the one who keeps the cheetu alive, collects subscriptions, and pushes the slow payers. In cases of default he has the option of accepting the loss himself, or dividing this with other players (with their consent), or dissolving the club and risking the ruin of his reputation. One has to bear in mind that regular meetings have become rare so that players, therefore, may have no inkling of what exactly goes on in their own club. This is the cost of the loss of the socializing function of cheetu. Because members have thrown the burden squarely on the shoulders of the president, it is reasonable that they compensate him in the form of a commission. Default, i.e. the risk that an early recipient withholds future contributions, in principal is borne by the organizer. Over time, organizers have developed a certain craft to protect the ROSCA against such mishap. At drawing-time they juggle the lots to try to place doubtful cases near the end of the cycle. They also collect contributions in parts, making several rounds instead of one to constantly remind members of their obligations. They defer payment of funds, or distribute funds in installments, even when this causes dissatisfaction and much grumbling among recipients.

Organizers understandably do not relish talking about default. One female president estimated that in a group with a size of twelve members, there is bound to be one defaulter. With a certain measure of resignation she volunteered that the defaulter is sometimes a relative, taking advantage of the situation. That would put the loss percentage at about eight, if the defaulter is the first recipient, which is unlikely, since the president knows her relatives' reputations. If the default takes place halfway through the cycle, the rate comes down to four percent. This seems a fair estimate and would explain why commissions seldom exceed the five percent level. The odds, however, do not explain why a person would be willing to take the president's job anyway. Somewhere in the game there must be additional compensation for the president.

Profile of an organizer; the rewards of the job.

The profile of the cheetu organizer/president in Sri Lanka has undergone a major facelift. The amiable, get-together atmosphere of yesterday's ROSCA is rapidly giving way to the impersonal version of savings and loan societies as purely a matter of arranging the financial affairs of the individual household and private business enterprise. Cheetu membership no longer is confined to the small communal in-group where the members know each other well. Now that farming has become an operation that involves a large outlay of cash, and population pressure has stimulated the search for off-farm employment and income earning opportunities in trade and craft, the demand for credit is large and growing and may not be effectively met. Members of a cheetu can be drawn from several villages and the auction system is becoming increasingly popular. This has its implications for cheetu strategy, calling for other mechanisms to regulate membership eligibility, group size, rotation of the fund, credit rating and repayment. The recent high rate of inflation has also had its effect.

The successful organizer nowadays is a businessman (or woman) with a firm financial reputation.5/ Only the financially strong can keep a ROSCA afloat by making contributions for members who cannot pay on time - which is bound to happen in an agricultural economy where income flows are irregular. Moneylending has become a logical extension of presiding over a cheetu and many members confirmed in interviews that they regularly borrow from the organizer. One of the attractions of joining a savings club is that it entitles

5/ Other organizers are those who have a regular income. In addition to drawing regular monthly wages, persons such as teachers and public servants can fall back on the custom of drawing advances on salaries.

participants to a line of credit in times of need. Who else can offer this security but a person of financial repute? Business people, for their part, have strong incentives to organize ROSCA and similar types of savings schemes. It enhances their reputation and creates goodwill, an indispensable condition for success in business. I have seen women in the very popular and competitive catering business who, as a service to clientiele, were expected to extend credit and organize ROSCA to stay in busines. Another category is the shopkeepers who may have to fall back on cheetu to get customers to pay their bills. Saving and credit services are a necessary package deal to maintain public relations.

Organizers also have a professional interest in savings schemes because of the opportunity to acquire working capital. To begin with, they are entitled to draw the first fund. Secondly, they may arrange with players to get contributions ahead of schedule by collecting weekly contributions in daily installments. Thirdly, organizers can delay payment of funds under the pretext that contributions are behind schedule or simply because they consider the winner a potential defaulter. Meanwhile members' savings are used for onlending or to finance private business. A week or a month's respite in capital-scarce economies may mean survival in the extremely competitive short term lending market. Daily loans, carrying ten percent interest, delivered in the morning and repaid in the evening, are common in the atomized market trade where a bunch of bananas is resold piecemeal, a pineapple is offered for sale in slices and a box of sugar in single lumps.

Finally there are commissions. Small payments can become quite attractive when an organizer presides over several clubs at a time, when contributions are substantial or the rotation cycle is very short as in daily cheetu. Managing ROSCA has become a profession that requires skill - but it pays, too. Unmistakably, there is in Sri Lanka a trend towards professionalization of the job. The days that such clubs are viewed as an agreeable pastime are over.

Summing up: the rationale of informal savings and lending arrangements.

All over the world people cherish the savings habit. Low and irregular income earning rural households in developing economies have special incentives to save in order to balance uneven flows of income and expenditure. Because of the smallness of actual savings and the indivisibility of prospective investments, the savings process takes a considerable gestation period to build up required sums. Savers who want to shed embarrassingly idle funds have a choice of depositing these in the formal or informal financial circuits. The surprising fact that many households save via informal channels, even without a reward in interest payment, requires an explanation.

The informal finance in Sri Lanka consists of a variety of individual and group agrangements. Individual arrangements typically involve persons of some financial and business repute in the community: storekeepers, rice millers, landlords, inputdealers and traders who usually combine several entrepreneurial functions.[6/] Surprisingly, many informal savings and credit groups in Sri Lanka are also presided over or organized by such persons. Many rural communities see these entrepreneurs as reliable depositories of savings and

6/ A recent Philippines survey of 163 informal lenders revealed an average of three business undertakings per moneylending (Presidential Committee, table 28).

dispensers of loans, acting without much delay and undue formality. Entrepreneurs regard financial services as an essential, even inevitable, extension of business operations. To organize savings clubs, to accept deposits and disburse credit enhances their reputation and goodwill and increase their potential range of activities. As a supplement to working capital, regular savings have a high opportunity cost. The acceptance of savings, moreover, establishes closer personal contact and allows the money-lender more intimate knowledge of his customers' financial standing and credit rating. Participation in group arrangements also keeps him informed and facilitates his lending decisions. He is not concerned with whether his loans are for productive investment, for tiding over periods of scarcity, or simply to make debtors' life a bit easier.

Rural people in developing economies, then, prefer to channel savings into informal financial circuits even when no interest is paid, because the absence of such payment is compensated by such factors as accessibility, flexibility and speedy as well as superior services. Most importantly, a savings deposit obviously creates a line of credit in times of need. These arrangements for saving and borrowing fit well into the balancing process used by rural households to budget their activities. Savings buy security and the need for security has always been a major determinant of human behaviour. By making life a bit easier, informal arrangements help realize social objectives that are the subject of professed concern in the design of credit policies in so many developing countries.7/

7/ As exemplified in the following dilemma. If a person wants to borrow for the purchase of a radio or to make a pilgrimmage, why not make him happy now instead of letting him wait and save to accumulate the necessary cash? Provided prospective borrowers have the required repayment capacity and can be expected to stick to the terms of the loan contract, why deny a loan to someone of limited means while granting it to another with ample resources?

Formal versus informal financial markets.

In an earlier paper I weighed the merits of the formal and informal capital markets in developing economies and stated that these two markets serve the interests of different types of clientele. I argued that a channeling of public funds into the rural economy via traditional circuits would require great care, lest a massive influx of capital would disrupt the fabric of social control in face-to-face relations (Bouman, 1978). Agricultural growth has proved less a matter of persuading people to change their ways of life through the carrot of cheap financial assistance than one of creating the necessary conditions that make growth feasible and attractive. In trying to keep provision of credit within the context of the socio-economic environment of the borrower, there is much to learn from traditional credit suppliers, especially in terms of what criteria to apply and what policy and procedures to follow.

The channeling of rural savings into the formal capital market could merely imply a transfer of resources from the informal to the formal financial circuit, which, in itself, is not a guarantee of optimum use of resources. Sensitive to risk and cost-accountancy, financial intermediation of the institutional sector is seldom performed in the interests of small scale entrepreneurs, farmers, traders and craftsmen. Quoting an IMF Staff paper of 1975, it was observed that, in the absence of bankable entrepreneurs and/or projects, banks may prefer to keep their funds idle rather than to channel them to second-best customers.

The recent history of the Peoples Bank in Sri Lanka is a case in point. This state-controlled bank is by far the most important financial institution of rural Sri Lanka. In 1980 it had 16 regional head offices and a network of 214 branches, partly in rural towns. Moreover, as the banker to the cooperative movement, it maintains 607 cooperative rural banks scattered over the island. It is also the main distributor of agricultural loans to cultivators.

The People's Bank, more than any other bank in the country, has acutely felt the impact of the official change in agricultural loan policies in Sri Lanka. Since the new administration stepped into power at the end of 1977, the Central Bank has largely stopped the distribution of cheap credit to agriculturists and has withdrawn its 75 percent guarantee on crop loans. Credit schemes had been amassing huge losses through an average loan delinquency of 60 percent for the years between 1967 and 1977. New regulations forced the banks to greater reliance on their own resources. The People's Bank already had a fine record as mobilizer of rural savings. Correctly assuming that vast reserves of savings still remained untapped, the bank stepped up its already successful savings campaigns. Paying attractive dividends on deposits, ranging from 14 to 24 percent in mid-1980, the savings accounts of its rural banks has almost doubled since 1977 and trebled since 1976.[8/] In June 1980, total savings deposits stood at a comfortable Rps 304 million. Crop loans, on the other hand, fell from an all-time record of Rps 365 million granted in 1977, to a meagre Rps 31.3 million granted for the crop season 1978/79 and further decreased to Rps 21.1 million approved for the season 1979/80. The impressive increase of savings deposits has thus not been accompanied by a corresponding disbursement of loanable funds in the rural economy. On the contrary, formal lending has virtually come to a standstill. This resulted in

8/ Inflation, on the other hand, hovered somewhere around 25 percent in the same period.

a net outflow of capital from the rural sector to the other sectors of the economy.

This situation is not peculiar to Sri Lanka. Desai noted that in India rural deposits in bank accounts also exceed rural loan. But the suddenness and massive extent of the reversal is rather unique and may have created problems in the informal financial sector. The situation in Sri Lanka raises the following interesting questions. Have resources been drained out of the informal financial circuit and how has this affected participants in the rural economy? And further, now that agricultural credit is no longer subsidized and banks have become more cost conscious, how well is the formal sector equipped to channel loans to a large number of rural borrowers, given the limits of its administrative and managerial capacities?

Comparative analysis: the case of the Philippines.

Discussions of the role of informal financial intermediaries in the rural economy of low income countries are usually much coloured by emotion, prejudice and a substantial lack of factual information. Accurate and reliable data are scarce; we welcome therefore the results of a recent survey of the informal financial markets in the Philippines (Presidential Committee, 1980). The study covers 912 farmers-borrowers and 163 moneylenders and sheds some light on the aftermath of a severe contraction of cheap public credit programs since 1974/75 due to high loan delinquency.

Surprisingly, food production in the country continued to grow. Private moneylenders rushed in to fill the gap, allowing farmers continued access to improved farm technology (page 35). The study reveals the existence of a "new crop of moneylenders," 75 percent of which has been in the lending business for less than 10 years at the time of the survey (1978). They themselves are beneficiaries of the so-called seed-fertilizer revolution and have expanded entrepreneurial activities through diversification of investment. They combine moneylending with at least three different undertakings, whether farming, product trade, rice milling, input dealing or storekeeping. This corresponds with the profile of Sri Lanka informal financial intermediaries and also with the findings of London in India.

This report helps do away with the popular notion of private moneylenders as monstrous usurers. Traces of monopoly profit were hard to find. Monopoly power is unlikely, given that few barriers to entry exist and the suggestion of strong competitive forces amongst the entrepreneurs-moneylenders. The actual annual interest rate charged averaged 55 percent against 110 percent prevailing some 20 years ago. This comes close to the 4 percent per month, found in Bolivia by Ladman, who also confirmed the apparent lack of monopoly profit.

Informal lenders in the Philippines also suffer from loan delinquency. Non-repayment of fully matured loans is recorded at 21 percent of the loans (page 29). The report, however, is not very clear on this point; elsewhere (page 25) it is estimated that only 3 percent of the total loan amount would become bad debts after three harvests. Still, informal lenders appear to be in a better position to minimize risk because of their efforts at diversification, at integration of product, input and credit markets and by charging different levels of interest rates. The study applauds the "creative adaptation of the moneylending techniques to suit local condition" (page 26).

Each moneylender serves only a small group of clientele in the Philippines. With the data supplied in the survey, one is able to calculate an average of 59 loans per lender. Lamdan found a maximum of only 23 loan contracts per moneylender in Bolivia (Ladman, page 5). This confirms the present author's impression that an informal financial intermediary lends to but a small group borrowers in Sri Lanka. Whether this is due to lack of funds or because of a perceived limit of his managerial capacity, is still unclear. Some moneylenders are reputed to use commission agents to expand their range of activities, and, in fact, one such case is cited in the Philippines study. But this certainly forces us to reflect on the administrative and managerial capacities of formal lenders. Given their limits, it is difficult to believe that formal lenders can provide loans to large numbers of small borrowers.

Finally, many informal lenders in the Philippines had access to institutional funds, provided either by banks, or by private commercial companies. Two of them even operated their own bank and were able to obtain rediscount facitilies from the Central Bank (page 32). The report concludes that "a scheme, deputizing farmer-moneylenders as financial agents of the lending institutions in the rural areas may well contribute to the development of the informal rural financial markets" (page 34).

Conclusions

A survey of Sri Lanka's consumers' finances by the Central Bank in 1973 estimated that the market share of the institutional sector in the rural credit market was no more than 21 percent. Some 80 percent of rural households, therefore, depended on the informal sector to regulate their finances. Since

1977, due to a severe contraction in the provision of formal-sector cultivation loans, the market share of the informal sector only increased.

Informal financial arrangements accommodate both borrowers and lenders in the rural economy, keen entrepreneurs frequently act as financial intermediaries to spread goodwill and expand business undertakings. They do accept savings deposits and raise additional capital for diversification in investment. They consider lending as an inherent component of the cost structure of the enterprise. A re-evaluation of the role of these intermediaries in the development process seems in order.

Quite commonly, savers do not receive any interest payment on deposits in the informal circuit. Apparently this inconvenience is offset by prompt access to a future line of credit for whatever purpose. Both lenders' and borrowers' transaction costs in the informal market are less than those prevailing in the formal sector. This is largely due to the existence of a reliable information system on the financial position of a small circle of participants, dealing with each other in face-to-face arrangements, adaptable to local conditions. Interest rates are usually higher, sometimes much higher, than those charged by formal lenders, accurately reflecting the high opportunity cost of capital and the risk of default on loans. Apart from disposing of a superior information system, informal lenders also have the advantage over formal financers in that they are able to charge differential rates of interest and reduce risk by diversifying into product, input and processing markets. The existence of monopoly profit is not clearly demonstrable since there are few barriers to entry into financial intermediation and competitive forces prevail.

Improvement of formal-sector savings services might capture a larger share of rural savings when interest rates on deposits are increased. This service to the poorer households may eventually, however, turn into a disservice when accumulated funds are drained out of the rural economy and such a drainage will negatively influence the performance of the informal financial market, on which the great majority of rural househodls still depends. Integration of both formal and informal circuits may be considered but requires careful monitoring. A first step would be to remove adverse legal restrictions on the operation of informal financial intermediary agents (Usury laws, Cheetu Ordinance, Chit funds bill) and abstinence from aggressive campaigns against moneylenders when no accurate and reliable data exist on their operations and practices. Given the evidence of a constraint that even informal circuits face to serve a large number of borrowers, and in view of the limited managerial and administrative capacity of formal-sector lenders, a next step could involve the tapping of private moneylenders as conduits of public funds to small farmers, traders and craftsmen. Experimenting with novel, innovative approaches to the realm of rural finance is long overdue.

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