

## Are ROSCAs providing an alternative funding source for poor?

Dr Madiha Khan

Department of Management Studies, University of Malakand  
[khanmadiha@hotmail.co.uk](mailto:khanmadiha@hotmail.co.uk)

### Abstract

This paper looks into ROSCAs as funding source for the poor. The evidence from the ROSCAs in Pakistan (Dera Ghazi Khan) suggests that regular incomes are essential for the smooth functioning of ROSCAs therefore ROSCA is popular among salaried classes. Poor people usually have insufficient and irregular incomes due to which they are considered trouble makers and therefore are excluded from the ROSCAs. In conclusion ROSCAs cannot provide funding for the poor people and thus cannot substitute microfinance.

**Key Words:** ROSCAs, poverty alleviation, finance, developing countries, Pakistan

### Introduction

Credit is essential particularly for poor (Rutherford, Collins and Johnson, 2013) as they cannot save big amounts on their own to initiate business or finance their working capital or to invest in fixed assets and so they need access to credit. Credit can help to smooth consumption particularly for those who face seasonal fluctuations in business. In addition to this, credit facilitates to meet sudden needs such as accidents or unusual events such as illness or may be marriage. Indeed, availability of the credit can increase ability of poor to absorb such shocks and to increase income by investing it into business.

However, poverty has several consequences one of which is financial exclusion. Poor are considered risky clients by the conventional banks because of many reasons for instance, they neither have financial collateral to offer to bank as security nor credit history or certain income sources. Even local money lenders extend loans to those who can offer physical collateral as security. Due to these, they have not been getting access to the funds in order to meet their financial needs until introduction of microfinance. Microfinance is designed to extend financial services to poor or low income people. Although there is little information in literature on the clients of microfinance but a look at success stories posted on the websites of microfinance banks clears that microfinance target market is composed of poor and small entrepreneurs engaged in household businesses such as handmade products, small shack stores, tailoring, etc ( e.g. Website of Khushhali bank).

A large number of research papers suggest that microfinance has positive impact on wellbeing of the poor (Mosley, 2001; Pitt et al., 2003;; Khandker, 2005; Chowdhury, Ghosh and Wright, 2005; ) and helped them to generate revenue and increase income when they invest it wisely into their business (Mosely and Hulme, 1998; Abbasi, Sarwar and Hussain, 2005) but in the last few years, microfinance has come under great criticism due to commercialisation and higher interest rates (Karnani, 2007; Bateman, 2010) particularly the initial public offering by compartamos in the year 2007 has worsened the situation.

The bank compartamos was established as an NGO. During the Mexican crises in 1995, organisation charged high interest rates to generate profits enough to attract private capital and then it transformed into for profit organisation in 2000. In the year 2007, it earned huge profit through initial public offering. Charging high interest rates deemed essential by the commercialised MFIs to attract private funding from capital market. It may be necessary for the MFIs to charge high interest rates but also raises concerns for the poor who may not come out of poverty as big portion of their income may go into the interest payments. The need for capital and negative effects of high interest rates has led development agencies to look for substitutes such as credit unions, ROSCAs etc.

Anthropological literature on ROSCAs suggests that ROSCAs are mostly used by low income class. For instance Ardener (1995, p.2), states that “where incomes are very low, where there is no formal social security network, where ill health stalks and a variety of calamities hover, a system of low-cost ROSCAs helps to meet the challenges for all ...” . Kurtz (1973) reports positive relation between poverty and ROSCAs’ participation. Calomiris and Rajaraman (1998) found existence of ROSCAs among poor people. These findings suggest that ROSCAs can be used as alternative funding source by the poor people and this paper aims to find out if ROSCAs can be used as substitute to microfinance.

This is a qualitative study and based on the data collected in year 2009 in Dera Ghazi Khan that is located in the southern Punjab of Pakistan. During the fieldwork of six months (May, 2009 - Oct, 2009), data was collected

through participant observation and semi structured interviews. In order to locate ROSCAs participants, snow ball method was used. There were 45 interviews each lasting on average 45 minutes, conducted from the participants of ROSCAs. In order to ensure accuracy, all interviews were tape recorded. The interviews were first transcribed in native language in order to carry preliminary analysis and then translated into English.

### **Rotating Savings and Credit Associations**

ROSCAs are informal and indigenous finance system (Besley and Levenson, 1996). It can be found in almost all parts of world (Ardener and Burman, 1995) and known with local names for instance *Tontine* in Cameroon, *Hui* in Taiwan, *Tanda* in Mexico, *Polla* in Chile (Armendariz & Morduch, 2005). A typical ROSCA is a group of individuals who decided to contribute a fixed amount each month and by the end of the month, the collected amount is given to one member who is selected through some predetermined criteria. Next month, another member gets the amount and so on. The receiver of the pot continues to contribute after receiving his pot and this process repeat until all members receive their lump sum once. Hence after that group of ROSCA is either disbanded or new cycle is started, may be with different members and different durations.

Literature on ROSCAs provided different rationale for ROSCAs' participation. Besley Coate and Loury (1993) in their paper make assumption that objective of participation is to finance purchase of indivisible durable goods particularly in the places where formal finance is underdeveloped and this is later proved by Handa and Kirton (1999) in their study on Jamaican ROSCAs. They found that 71% of the ROSCA members use their money to acquire durable goods. Srinivasan (1995) studied ROSCA in oxford and reported that people participate in ROSCAs to pay for children's fees, daughter's dowry, funeral ceremonies etc. Some research studies suggested that ROSCAs are used as insurance instruments in less developed areas (Calomiris and Rajarman, 1998; Klonner, 2003).

Individuals are credit constrained and ROSCAs can provide funds to those without access to credit market. Besley, Coate and Loury (1993) investigated impact of ROSCAs on the wellbeing of people and reported positive impact without having access to formal finance markets. Another study found that participants of ROSCAs have more durable assets as compared to non participants (Besley and Levenson, 1996). Such findings support the contention that ROSCAs can improve wellbeing of the people.

### **Analysis and Discussion**

ROSCAs can be successful only if people continue to pay after receiving their lots. There is no legal and written contract that may force participants to make their payments (Khan, 2012). It implies that ROSCAs are very risky however there is reported rare/no default in ROSCAs. There can be many reasons for rare default for instance social sanctions (Khan, 2012), careful selection of the ROSCAs members, etc that may reduce the default. This paper will look at the selection criteria of ROSCAs to determine who the people excluded from the ROSCAs.

During the analysis of interviews, it is found that ROSCAs members are evaluated and selected carefully in order to avoid future troubles. Thus, a person may not be given membership even he is a close friend or poor relative if he is considered unsuitable for the ROSCA particularly by the president of the ROSCA. President is the one who organise the ROSCA, receives the first pot of money and is responsible to collect payments from the members and to draw lots (Srinivasan, 1995; Brink and Chavas, 1997). It is also important for the successful completion of cycle of a ROSCA.

The selection criteria and selection process is not formally recorded anywhere, but it can be deduced from the spoken texts of the interviewees. The analysis of these spoken texts helps to provide an understanding of how the selection criteria can lead to the exclusion of certain individuals/groups. It is found that there are certain characteristics that make a particular person a suitable/desirable member for the ROSCA. Thus, some people are welcomed and given easy access to ROSCAs while some are considered risky and therefore, do not given membership. In the following, interviewees' excerpts will be analysed to investigate who these unsuitable and undesirable candidates are?

Before discussing the interview excerpt, I would like to share my research findings on who are interviewees? ROSCAs is popular among salaried and housewives. I also found many ROSCAs running in the bazaar of Dera Ghazi Khan (For more discussion Khan, 2012). These people like to make group with other salaried people for instance take example of following excerpt.

	<b>RQ-29.1</b>
1	<b>Interviewer:</b> What type of people pay promptly?
2	<b>Interviewee:</b> People who have regular income.
3	Salaried people get their salary on 2 <sup>nd</sup> or 3 <sup>rd</sup> of the month.
4	They pay their committee on time. Daily wage earners
5	are trouble makers. We do not include them. The purpose
6	of the committee is to help people meet their need, if it is
7	not available in time then there is no benefit of it.
	(RosUrban-F29)

The woman in the above quote (RQ-29.1) is a sempstress and her husband is an employee of 14 grades in WAPDA (Water and Power Development Authority). She along with her sister run this ROSCA. The interviewee tells that daily wage earners cannot make timely payments and therefore are not good members. She does not give membership to such people in her ROSCA. In the quote, she labels daily wage earners as trouble makers which according to her, refers to those who make late payments. There are excerpts below in which interviewee has same opinion about the daily wage earners as the previous interviewee (RQ-29.1).

	<b>RQ-30.1</b>
1	It is better not to include daily wage earners as, if
2	you include them, they will not pay on time and you will
3	be in trouble.
	(RosUrban-F30)

	<b>RQ-34.1</b>
1	Daily wage earners create trouble for everybody. I have to
2	make several visits. I have to answer to other members of the
3	committee as well.
	(RosUrban-F34)

There are others excerpts supporting the idea that small businessmen and daily wage earners are associated with late payments and late payers. “I do not include her. She always remained in financial trouble.....her husband is street vendors” (RosUrban-F45), “we include only salaried people” (RosUrban-M20). Indeed, analysis of the interviews found a consistent frame developing in which daily wage earners are not considered to be suitable members for the ROSCAs mainly due to their uncertain and unpredictable income. This ultimately leads to the exclusion of such groups from the ROSCAs.

In order to understand why daily wage earners are not welcomed in ROSCAs, it is important to study this category in more detail. Wyman (2007) carried a study to explore income sources of people who live below \$2 a day and reported only 500 million get their income through salaried jobs or microenterprises while rest of the people are wage earners or engaged in small scale businesses activities such as fishing, pastoral activities etc. Other income generation activities of the poor may be garbage collecting, making and selling pickle (Banerjee and Duflo, 2007). Daily wage earners or the street vendors are most vulnerable and susceptible to seasonal fluctuations. They may not earn income for days in unfavourable weathers. Thus, poor not only have low but irregular income that results in inability to make timely payments. Due to this they are not given access to ROSCAs funds which is in one way, very important for the survival of ROSCAs.

The survival of a ROSCA depends on the payments made by the members. When members cannot make payments on time, the receiver of the pot will either get half pot or may get his pot late which makes ROSCAs ineffective because the received pot may not be sufficient to meet the need of the poor whether the member need it to purchase indivisible durable item or to pay for children’s fees. It become even more important when members of the ROSCAs are micro-entrepreneurs as their business will suffer due to late payment.

## Conclusion

Poor people usually have low and unpredictable incomes due to which they need credit to smooth consumption which is provided by microfinance. The criticism of microfinance has forced to seek alternatives one of which is ROSCAs. The analysis of the interviews of ROSCAs participants suggested that ROSCAs do not favour poor people with low particularly irregular income due to which they cannot pay regular payments that is crucial for the successful completion of the ROSCA cycle. In addition to this, ROSCAs become ineffective if they cannot serve people needs. This leads to the conclusion that ROSCAs cannot provide funds to the poor and hence cannot substitute microfinance.

## References

- Abbasi, F., Sarwar, M. N., & Hussain, S. (2005). Microfinance route to income generation and poverty reduction: Evidence from district Faisalabad, Pakistan *Journal of Agriculture and Social Sciences*, 1(2), 144-147.
- Banerjee, A.V., and Duflo, E. (2007). The economic lives of the poor. *Journal of economic perspectives*, 21(1), 141-167.
- Khandker, S. R. (2005). Microfinance and poverty: Evidence using panel data from Bangladesh. *The World Bank Economic Review*, 19(2), 263-286.
- Klonner, S. (2003). Rotating savings and credit associations when participants are risk averse. *International Economic Review*, 44(3), 979-1005.
- Mosley, P. (2001). Microfinance and poverty in Bolivia. *The Journal of Development Studies*, 37(4), 101-132.
- Pitt, M. M., Khandker, S. R., Chowdhury, O. H., & Millimet, D. L. (2003). Credit programs for the poor and the health status of children in rural Bangladesh. *International Economic Review*, 44(1), 87-118.
- Wyman, O. (2007). *Sizing and Segmenting Financial Needs of the World's Poor*. New York: B & M Gates foundation.
- Chowdhury, M. J., Ghosh, D., & Wright, R. E. (2005). The impact of micro-credit on poverty: Evidence from Bangladesh. *Progress in Development Studies*, 5(4), 298-309.
- Mosley, P., & Hulme, D. (1998). Microenterprise finance: Is there a conflict between growth and poverty alleviation? *World Development*, 26(5), 783-790.
- Besley, T., Coate, S., & Loury, G. (1993). The economics of rotating savings and credit associations. *The American Economic Review*, 83(4), 792-810.
- Besley, T., & Levenson, A. R. (1996). The role of informal finance in household capital accumulation: Evidence from taiwan. *The Economic Journal*, 106(434), 39-59.
- Brink, R. v. d., & Chavas, J. (1997). The microeconomics of an indigenous African institution: The rotating savings and credit association. *Economic Development and Cultural Change*, 45(4), 745-772.
- Handa, S., & Kirton, C. (1999). The economics of rotating savings and credit associations: Evidence from the Jamaican 'Partner'. *Journal of Development Economics*, 60(1), 173-194.
- Mittmann, K. & Ihsan, Z. (1991). *Culture shock: A guide to customs and etiquette*. London: Kuperard.
- Rutherford, S., Collins, D., and Johnson, S. (2013) Clients. In J. Ledgerwood, J. Earne, and C. Nelson. (Eds.) *The New Microfinance Handbook: A Financial Market System Perspective*. Washington D.C. : The Worldbank
- Ardener, S., & Burman, S. (Eds.). (1995). *Money go rounds: The importance of rotating savings and credit associations for women*. Washington DC: Berg.
- Armendáriz, B., & Morduch, J. (2005). *The economics of microfinance* (2nd ed.). London: MIT Press.
- Srinivasan, S. (1995). ROSCAs among South Asians in Oxford. In S. Ardener, & S. Burman (Eds.), *Money-go-rounds: The importance of rotating savings and credit associations for women*. Oxford: Berg.
- Karnani, A. (2007). Undermining the chances of sustainable development in India with microfinance. In M. Bateman (Ed.), *Confronting microfinance: Undermining sustainable development* (pp. 83-96). Sterling, VA: kumarian Press.
- Bateman, M. (2010). *Why doesn't microfinance work?: The destructive rise of local neoliberalism*. London: Zed Books.
- Ardener, S. (1995). A comparative study of rotating credit associations. In S. Ardener, & S. Burman (Eds.), *Money-go-rounds: The importance of rotating savings and credit associations for women* (pp. 289-318). Oxford: Berg.
- Calomiris, C. W., & Rajaraman, I. (1998). The role of ROSCAs: Lumpy indivisibles or event insurance. *Journal of Development Economics*, 56(1), 207-216.

This academic article was published by The International Institute for Science, Technology and Education (IISTE). The IISTE is a pioneer in the Open Access Publishing service based in the U.S. and Europe. The aim of the institute is Accelerating Global Knowledge Sharing.

More information about the publisher can be found in the IISTE's homepage:

<http://www.iiste.org>

## CALL FOR JOURNAL PAPERS

The IISTE is currently hosting more than 30 peer-reviewed academic journals and collaborating with academic institutions around the world. There's no deadline for submission. **Prospective authors of IISTE journals can find the submission instruction on the following page:** <http://www.iiste.org/journals/> The IISTE editorial team promises to review and publish all the qualified submissions in a **fast** manner. All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Printed version of the journals is also available upon request of readers and authors.

## MORE RESOURCES

Book publication information: <http://www.iiste.org/book/>

Recent conferences: <http://www.iiste.org/conference/>

## IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

