POLICY BRIEF

Financial Inclusion for Poor Households in Uganda:

The Role of Semiformal Institutions

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Executive Summary

Most households in Uganda lack access to banks and rely instead on semiformal organizations, such as village savings and loan associations (VSLAs), rotating and savings credit associations (ROSCAs), and savings and credit cooperatives (SACCOs), to meet their financial needs. This study examines whether these semiformal organizations improve the household welfare of their participants and whether they provide benefits to participants comparable to those offered by banks to their users. We found that participation in VSLAs, ROSCAs, and SACCOs increased household food security, clothing expenditure, and school enrollment and conferred welfare benefits to participating households comparable to those conferred by banks. Efforts to deepen financial inclusion in Uganda could thus be best accomplished by using VSLAs, ROSCAs, and SACCOs, to which poor and marginalized groups have better access.

Introduction

Financial inclusion means that people or businesses have access to useful and affordable financial products and services that meet their needs. It implies delivering financial services at affordable costs to disadvantaged and low-income segments of society, who in most cases currently do not have access commercial bank services. Financial inclusion has been shown to reduce poverty and spur economic growth (FINCA, 2021; World Bank, 2018).

In Uganda most households lack access to banks and traditional microfinance institution services. About 6 out of 10 Ugandan adults rely on semiformal financial services to meet their financial needs (Fin-Scope Survey, 2018). These households are served by semiformal organizations like village savings and loan associations (VSLAs), rotating and savings credit associations (ROSCAs), and savings and credit cooperatives (SACCOs). There is an urgent need to deepen financial inclusion in Uganda using these semiformal institutions. The government of Uganda has plans to put in place measures to increase poor households' access to formal financial services, as enshrined in the National Development Plan-III Report (2020).

The study on which this brief is based sought to address two questions: First, can poor households improve their welfare when they get access to financial services from VSLAs, ROSCAs, and SACCOs? Second, are the benefits from VSLAs, ROSCAs, and SACCOs comparable to those banks offer to their customers?

Research Approach

The data used in this research are from the World Bank LSMS Survey 2018–2019 for Uganda (UBOS, 2020). In this study, we defined household welfare narrowly to include food and nutrition security, expenditure on clothing, and school enrollment rates. To test whether VSLAs, ROSCAs, and SACCOs confer welfare benefits on their members and whether those benefits are comparable to those conferred by commercial banks, we used propensity score matching (PSM) and complemented the analysis with the two-step treatment effects (IV sample selection) method. From the data obtained from the World Bank LSMS Survey 2018–2019 for Uganda, we constructed two groups of households that shared similar characteristics: (i) a control group (households that did not use any services from banks, Microfinance Institutions, Microfinance Deposit-taking Institutions, VSLAs, ROSCAs, or SACCOs); and (ii) a participating group (households that used banks, VSLAs, ROSCAs, and SACCOs). The participating group had four sub-samples. First we had households that **only** had services from bank and **nowhere else**. Second, households that **only** had services from VSLAs and **nowhere else**. Third, households that **only** had services from ROSCAs and **nowhere else** and finally household that **only** had services from SACCOs and **nowhere else**. Using these matched groups, we estimated the impact on household welfare of accessing services from banks, VSLAs, ROSCAs, and SACCOs.

Main Findings

First, we looked at welfare outcomes for the full sample of participants and nonparticipants in VSLAs, ROSCAs, and SACCOs. We found that access to financial services from VSLAs, ROSCAs, and SACCOs actually improved household dietary diversity score (HDDS), food consumption score (FCS), school enrollment rates (ratio of children in school to total children), and annual expenditure on clothing. The results also showed that the welfare benefits conferred upon poor households by VSLAs, ROSCAs, and SACCOs are comparable to those conferred by commercial banks upon bank customers (Table 1).

Table 1: Household welfare outcomes for participants and nonparticipants in banks and semiformal financial services

Institution	Outcome measured	Participants	Nonparticipants	Difference	Significance
Banks	HDDS	9.546	8.957	**0.589**	Significant
VSLAs	HDDS	8.886	8.433	**0.453**	Significant
ROSCAs	HDDS	9.227	8.671	**0.556**	Significant
Banks	FCS	58.276	54.341	**3.935**	Significant
ROSCAs	FCS	55.196	51.461	**3.735**	Significant
Banks	School enrollment ratio	0.623	0.540	**0.083**	Significant
ROSCAs	School enrollment ratio	0.546	0.470	**0.076**	Significant
VSLAs	School enrollment ratio	0.555	0.476	**0.079**	Significant
SACCOs	School enrollment ratio	0.657	0.504	**0.153**	Significant

Banks	Clothing expenditure (USh)	394,173	153,126	**241,047**	Significant
ROSCAs	Clothing expenditure (USh)	201,324	107,552	**93,772**	Significant
SACCOs	Clothing expenditure (USh)	204,711	116,595	**88,116**	Significant

Source: Authors' Statistical Analysis. Exchange rate: US$1.00 = USh3,600.

Note: Scores are averages for each group (participants and nonparticipants). VSLAs = village savings and loan associations. ROSCA = rotating and savings credit associations. SACCOs = savings and credit cooperatives. HDDS = household dietary diversity score. FCS = food consumption score.

Next we examined the impacts of access to financial services from banks, VSLAs, ROSCAs, and SACCOs on the household welfare of participants and nonparticipants within the following subsamples:

- Households that experienced drought
- Households that experienced drought, pests, and heavy rains
- Households where farming is the main occupation
- Male-headed households
- Households where the head's education is below the sample average
- Rural-based households

The results were similar to those for the full sample. Within the six subsamples, access to financial services from VSLAs, ROSCAs, and SACCOs improved HDDS, FCS, clothing expenditure, and school enrollment rates. The welfare benefits from VSLAs, ROSCAs, and SACCOs were also comparable to those from commercial banks for participating households within the subsamples.

Policy Implications and Recommendations

Overall, we found that access to financial services from VSLAs, ROSCAs and SACCOs improves household welfare. This improvement is comparable to that obtained by commercial bank customers. Our findings are robust to whichever dataset we used (full sample or the six subsamples).

There is a need for the government of Uganda to work with the private sector, nongovernmental organizations, and community-based organizations to reach financially excluded adults, who consist mostly of young people, women, and rural residents. In 2017 the government of Uganda formulated the National Financial Inclusion Strategy (NFIS 2017–2022) to reduce financial exclusion and barriers to accessing financial services. According to the National Development Plan-III Report (2020), it put in place plans to increase poor households' access to formal financial services.

Given that about 6 out of 10 Ugandan adults rely on semiformal financial services, deepening financial inclusion in Uganda could be best accomplished by using VSLAs, ROSCAs, and SACCOs, which are closer to poor and marginalized groups. Compared with commercial banks and traditional microfinance institutions, VSLAs, ROSCAs, and SACCOs do not require substantial investment in physical and institutional infrastructure. Financial inclusion can be scaled up through these institutions by targeting priorities such as economically active women, youth, and the rural population in general.

Overall, there is an urgent need to prioritize and put into practice the National Financial Inclusion Strategy to increase the geographic spread and depth of financial outreach of VSLAs, ROSCAs, and SACCOs in Uganda.

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