Discussion

Introduction: Microfinance and poverty reduction

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Microfinance has become a critical component of community development and poverty reduction strategies. In this special issue of the *Development Bulletin* the advantages and difficulties of implementing effective microfinance programmes are explored from a number of different perspectives. In particular, there is considerable discussion as to the extent that microfinance projects assist the very poor and whether or not they empower women. While these papers show that there are some basic steps that identify good microfinance from charity or goodwill welfare, the nuances possible are extensive.

The 28 papers in this special issue have been selected from a large number of contributions. They address issues that are central to four basic themes in microfinance: outreach, best practice, gender, and human resource development. These themes are explored in a number of case studies.

Issues of outreach

There are nine outreach papers, beginning with a paper that describes the role that microfinance plays in AusAID's commitment to poverty reduction. David Gibbons stresses the critical importance of supply constraints to the rapid growth of microfinance outreach for targeted poverty reduction. He presents his argument in a logical and heuristically powerful manner. Wright and Mutesasira do likewise, but they address one of the truly important problems that besets all savings-based microfinance - the management of risk. In so doing these two authors highlight the attention that all practitioners must give to ensure that the savings products and services they offer potential clients are appropriate to the circumstances. Wright and Mutesasira stress that savings services are an important strategy with which to ensure that the poor are key beneficiaries of microfinance. This theme is critical to outreach.

Alison Mathie takes up this theme in ways that place the impact of microfinance on the incidence and severity of poverty squarely on the development agenda that microfinance must serve if it is to realise its promise. The final four papers on outreach draw the reader to consider the contribution that new products can play in bringing microfinance to larger numbers of poor households. These products include insurance, strategic alliances with NGOs or non-bank financial intermediaries, innovations in process and bureaucratic procedures, policy changes that bear on regulation and redressing of market failures, and donor agencies as sources of resources and analytic capacity.

Issues of best practice

Each of the five best practice papers has a unique context and focus, but all share a common body of received wisdom. Each highlights the importance of choosing pricing policies, management and transparency practices that do not contradict the stated goals of increasing financial viability and client self-reliance. How one begins is important. Cost recovery is important. Charity is an obstacle that is difficult to recover from once relied upon. Being demand driven is one way of keeping on the straight and narrow. But, one cannot be demand driven if the 'business' is based on assumptions about what poor households need in the way of financial intermediation.

Does microfinance benefit poor women?

Few areas of microfinance are more contentious than the subject of whether microfinance is truly as beneficial to the plight of poor women as we might want to believe. The gender papers included in this journal do not allow an unequivocal conclusion. However, they raise important questions. Some of the data presented is anecdotal, but even if only a minority of women experience the negative effects described by Zafar, Rozario or Hunt and Kasynathan, does this justify MFIs ignoring the problem because it is not commonplace? Clearly the answer must be in the negative, but the problem of how to avoid such problems is not so easy. Todd offers a hopeful yet pragmatic contrast to the negative findings of several of the papers here, reminding us that as practitioners we must not slip into the trap of being too paternalistic. It is all too easy to assume that poor women need to be protected because they are vulnerable and open to exploitation and abuse. This is not an argument against microfinance. It is a comment on the systemic nature of chronic poverty and the sources of vulnerability of poor women. In the interests of open debate, the contrasting views in these papers is presented for your assessment.

Case studies

This issue includes a number of important case studies, each with unique features. Carlos Ani reminds us of the importance of research as a foundation stone for successful innovation. Helen Todd shares details and insights of her experiences with microfinance in East Timor (Viewpoint Section). Judith Shaw recounts her findings on the role that 'location' played in the case study she undertook in Sri Lanka, while John Newsom, Byford and Guanara, and Karen Lewin relate details of the difficult road that microfinance has travelled in Papua New Guinea where special attention is given to the post conflict situation in Bougainville. Mark Deasey, on the other hand, examines lessons learned by Oxfam/CAA from its experiences implementing microcredit in China, Laos, and Vietnam.

Human resource development

The closing theme addressed by the final two papers is human resource development for successful microfinance. Helzi Noponen offers the reader an insight into what she calls the 'Internal Learning System'. The focus here is on participant training. Christopher Dunford considers a unified microfinance delivery system and educational processes that can accompany this.

Microfinance in the Australian aid programme

Kieran Donaghue and Stav Zotalis, AusAID

Introduction: How does AusAID understand microfinance?

Microfinance is about giving the poor access to the financial services they need to exploit income-earning opportunities, to meet life-cycle needs and to deal with emergencies. Microfinance can therefore both enhance the capacity of the poor to *increase* incomes and accumulate assets and *protect* them from further impoverishment in times of economic stress.[1]

High-quality microfinance is characterised by services that are easily accessible to the poor, responsive to the full range of their financial needs and reasonably priced. With the partial exception of some informal arrangements,[2] effective microfinance is available on a long-term basis, since the need for the lump sums that microfinance makes available is on-going. One or two doses of small scale credit rarely make a substantial difference to the lives of the poor. Long-term and reliable access to a range of financial services can make a big difference.

Long-term access to finance requires *sustainable providing organisations*, whether these be self-managed financial coo peratives such as savings and loans associations, professionally managed microfinance institutions (MFIs), formal financial institutions or some other organisational form.

Sustainable financial organisations have learned to protect against delinquency and default, to keep their costs down and to charge interest rates that cover the full cost of delivering their services. They recognise that permanency in the community is essential to fulfilling their mission of serving the poor, as well as being a powerful incentive for repayment. They are normally led by people with a clear vision of their organisation as something for the long term, not an isolated aid project with a limited life.

However, relatively few microfinance organisations have reached financial self-sufficiency, and in many cases this limits their access to the funds needed to increase the scale of their operations. Worldwide, a relatively small number of MFIs account for a disproportionately large share of microfinance clients. A ‘second generation’ of high quality organisations is needed to help meet the gap between supply and demand.

The strong emphasis placed on self-sufficiency is not without its critics, with the question of the extent to which the pursuit of self-sufficiency leads microfinance organisations to focus on the less poor remaining the subject of intense debate.

AusAID’s experience

Over the last three years the Australian overseas aid programme has made a concerted effort to build the size and quality of its microfinance portfolio. In doing this the government’s aid agency, AusAID, has focused on identifying and, where necessary, strengthening the capacity of developing country organisations showing the potential to become long-term providers of financial services to the poor. This approach is in line with the view of the Consultative Group to Assist the Poorest (CGAP)[3] that the lack of retail capacity – organisations providing financial services directly to poor clients – is the biggest single constraint to the rapid expansion of microfinance.

At the same time, AusAID has found that some MFIs which already have the capacity to scale up still lack access to the necessary funds to cover increased operational costs and additional loanable funds. Grant funding for such organisations, provided it does not weaken incentives for efficient operations that can eventually dispense with subsidies, can be an appropriate response in these circumstances.

It might be objected that focusing on individual MFIs is a ‘picking winners’ approach, and that donors such as AusAID would be better advised to concentrate on helping to improve the policy environment for microfinance in partner countries and allow the market to elicit effective providers. This objection overlooks the evidence that, while a poor policy environment (for example, unrealistically low limits on permissible interest charges) can inhibit the development of microfinance, a good policy environment does not of itself ensure a strong industry. There is much to be said for the argument that the demonstration effect of a few highly successful MFIs has been the strongest driving force in the expansion of microfinance.

Against this background, the attempt by aid donors to identify and support the growth of strong microfinance organisations is fully justified, although this need not be at the expense of interventions at the policy level or in such areas as regulation and supervision where these stand a reasonable chance of success and where the changes sought would be likely to have a high impact.[4]

South Asia and Southeast Asia

The focus on building retail capacity is heavily dependent on the existence of local organisations with the potential to become significant players. In South Asia and parts of Southeast Asia, such organisations exist in significant, although far from unlimited, numbers. As a consequence, Australia is pursuing a number of new activities in these regions. A five-year $A5.5 million project to support the expansion of a specialist microfinance organisation in Vietnam – the Capital Aid Fund for the Employment of the Poor (CEP Fund) in Ho Chi Minh City – began in June 2001. A successful scaling-up programme by CEP Fund could have a significant demonstration effect on the rest of Vietnam's microfinance sector.

In Nepal, AusAID began a collaboration last year with a wholesale microfinance provider: the Rural Microfinance Development Centre (RMDC).[5] In countries such as the Philippines and Bangladesh, local wholesale MFIs are playing an increasingly important role in developing the microfinance industry. RMDC may come to play a similar role in Nepal. In Pakistan, AusAID and CGAP undertook in October 2000 a joint appraisal of KASHF Foundation, one of the few specialist microfinance providers in the country. This has resulted in joint funding of KASHF by CGAP and AusAID.[6] Pakistan's microfinance sector is one of the weakest in South Asia, and the development of a market leader such as KASHF Foundation is likely to be an important stimulus for the sector's growth.[7]

Project designs have been prepared for multi-year scaling-up programmes in northwest Bangladesh through the Bangladesh Rural Advancement Committee (BRAC) and in the Chittagong Hill Tracts of Bangladesh through the Integrated Development Fund (IDF). The BRAC proposal focuses on one of the poorest regions of the country, while the IDF expansion would take in relatively remote areas that include significant tribal populations.

Funding decisions on these activities will be made shortly.

East Timor

In East Timor, AusAID is supporting two microfinance initiatives: the non government organisation Moris Rasik, and the Trust Fund for East Timor-funded, Asian Development Bank-managed Microfinance Project (MFP).[8] Moris Rasik established a group-based microfinance programme in October 2000 exclusively for poor, rural women. After one year of operations it is providing loans to 400 households in the Bobonaro district and has just begun an expansion to the Suai district. AusAID support will help to strengthen the financial and management capacity in Moris Rasik, with a particular focus on East Timorese staff. More information on Moris Rasik is provided in the article by Helen Todd in this issue.

The MFP is seeking to develop a strong policy framework for microfinance, to rehabilitate, strengthen and expand credit unions and to establish a financially sustainable Microfinance Bank serving the poor. AusAID is supporting the MFP, both as a contributor to TFET and as Trustee of the Foundation that will act as initial owner of the Microfinance Bank.

Papua New Guinea and the Pacific

In some of the regions of major interest to the Australian aid programme, prospects for sustainable microfinance are uncertain. In many of the South Pacific countries, no 'market leader' has emerged. There have been few demonstration effects to kick-start the microfinance sectors in the various countries, and these remain very weak.

A variety of arguments based on cultural and economic features of South Pacific countries have been put forward to explain the lack of successful microfinance in this region.[9] However, it is difficult to determine whether the lack of success reflects inherent features of these countries or, rather, the absence to date of the innovation needed to introduce microfinance successfully into an environment very different from its South Asian or Latin American heartland.

AusAID is supporting a project on Bougainville that may point the way towards a more successful model of small-scale finance for the South Pacific. Bougainville Haus Moni is a savings-first approach, with a focus on establishing the capacity for self-management of the provision of financial services. This project is discussed in more detail in the article by John Newsom in this issue.

AusAID is also supporting a small project aimed at providing microfinance to the rural and outer islands of a number of South Pacific countries through credit union savings clubs (CUSCs). These are essentially a simpler version of a credit union, requiring fewer officials and a much simplified level of bookkeeping. The first part of the project has confirmed the demand for CUSCs. The second phase will facilitate their establishment through changes to the credit union standard by-laws, development of systems, and training of officials in the operations and monitoring of CUSCs.

China

AusAID has on occasions supported the provision of credit as a component of larger projects dedicated to objectives such as increasing agricultural productivity or expanding income-generating opportunities. Particularly where the credit component has been small, this approach can result in insufficient attention being given to the sustainability of the provision of credit and other financial services beyond the life of the project, and of the conditions necessary to ensure this sustainability.

The Qinghai Community Development Project in China represents a sounder approach. This project began in 1994 and was completed in August 1998. Credit provision was one of the three core components designed to increase the income-earning opportunities of poor villagers. Initially the credit programme was managed through the project, in conjunction with the Haidong Branch of the Agricultural Bank of China (ABC). However, in April 1998 management of microcredit provision was transferred to the ABC under a separate board of management, with AusAID representation to monitor performance. This transfer of responsibility was designed to ensure that the microcredit programme would continue when the project finished.

Subsequent assessments by both AusAID and CGAP have shown that, while the project has established the basis of a sustainable microfinance programme in Qinghai (among a number of other positive outcomes),[10] much remains to be done in areas such as portfolio management, information systems and client targeting to give Qinghai a realistic chance of sustainability while maintaining a focus on the poor. As a result, the Qinghai Microcredit Consolidation

Project has been designed to address these shortcomings. At the time of writing it is in the tendering process.

The Qinghai model is unusual in that it combines the facilities of an established financial institution (the ABC) with commission-based village collection agents. This approach was designed to reduce the cost of providing services to widely dispersed population groups. While this innovation appears to have worked well in terms of facilitating a significant take-up of the services on offer, there have been difficulties in ensuring that the rules of the scheme have been fully understood by villagers, and that the rules have been applied equitably and consistently. One of the tasks of the Consolidation Project will be to address these problems.

The approach AusAID has taken in Qinghai is a form of 'downscaling', whereby a formal financial institution is encouraged to develop new financial services and new methods of service delivery to reach clients who were previously excluded. While this approach has had some notable successes,[11] generally speaking it has been the 'upscaling' of non government organisations (NGOs), whereby they have developed the tools needed to put the provision of financial services on a sustainable basis and to expand their programmes to reach far larger numbers, that has been the key feature of the development of microfinance.

China lacks a strong NGO sector on which such an 'upscaling' programme could be based. However, there are some promising initiatives. Funding the Poor Cooperative (FPC) is the leading non government microfinance provider in China, with more than 13,000 active clients. FPC uses the Grameen Bank solidarity group methodology to provide loans to the poor, and it has demonstrated that the basic model can work in China. This is confirmed by CGAP, which undertook a detailed appraisal of FPC in October 2000. AusAID, through the microfinance seed fund, is supporting FPC's expansion programme in Nanzhao County in Henan Province and Yixian County in Hebei Province.

China is an enormous potential market for microfinance, given the millions of low income households that lack access to basic financial services. However, microfinance is a relatively new industry in China, with only five to ten years of experimentation in rural areas. A number of pilot projects have been successful in reaching the poor and have generated important lessons about the local market for small scale financial services. However, for the most part (FPC may be an exception), the pilots appear to lack the management systems to support rapid expansion and long-term sustainability.

In this context, the work that AusAID is undertaking, though small in scale, has the potential to provide important lessons for how best to realise the vast potential of microfinance in China.[12]

Microfinance and poverty reduction

Reducing poverty and achieving sustainable development is at the heart of the Australian aid programme. A recent policy paper on the programme's approach to reducing poverty identifies four 'pillars' of the programme's poverty framework: growth, productivity, accountability, and vulnerability.[13] Facilitating access by the poor to key productive assets, such as land and credit, is one of the ways in which the aid programme seeks to increase the productivity of the poor.

The policy paper draws a distinction between activities that *directly* target clearly defined poor beneficiaries, and those *indirect* activities that operate at sectoral or national/state levels. These include governance, policy dialogue and institution-building activities. The paper makes the point that indirect activities often have the greatest medium- to long-term impact.

Most of the microfinance work that AusAID has done to date falls closer to the 'direct' end of the spectrum. Indeed, one of the powerful features of microfinance as a means of tackling poverty is that it puts financial resources directly into the hands of the poor. It provides the financial capital that in the right circumstances allows the poor to make more effective use of the human and social capital they already possess.

But there is also a strong 'indirect' element to AusAID's support for microfinance. This is evidenced by the focus on building the capacity of organisations to deliver services on a long-term basis to increasing numbers of the poor. Indeed, some critics of microfinance argue that practitioners and donors give *too much attention* to the microfinance organisation, as if creating financially self-sufficient organisations is an end in itself and not a means to the end of poverty reduction.

AusAID believes that this criticism, while understandable, is misplaced. Building organisations focused on serving the poor, whatever form these organisations take in terms of the role of members and the reliance on professional as against voluntary labour, is crucial to the reduction of poverty. Indeed, it is hard to see how sustainable solutions to poverty are possible without the existence of an organisational infrastructure that is accessible to the poor and that addresses their needs. The microfinance sector is surely right in placing the need to build sustainable organisations at the centre of its attention.

The framework developed by CGAP for appraising microfinance organisations is a very useful tool in this respect. It focuses attention on the various factors that underpin organisational success: the history and mission of the organisation; its ownership and board of directors; its leadership, alliances, human resources, organisational structure and internal controls; its target clients and the services it offers; its loan portfolio quality and financial performance; and its near to medium-term objectives. Performance and potential in terms of these organisational features determine whether it is worth investing in a given microfinance organisation.

AusAID is making increasing use of this framework in its appraisal of potential partner organisations. Although the format has been designed for use with 'relatively mature' MFIs, AusAID has found that it can be adapted for use with organisations at very different levels of development.

Conclusion

Australia has made a concerted effort over the last three years to expand its contribution to the development of the microfinance sector in those countries where it provides development assistance.

The microfinance seed fund has greatly helped in the process of identifying and developing initiatives that in some cases have then been handed on to the relevant AusAID country programme for further funding.

In undertaking this work AusAID has drawn on both Australian experience and expertise and that of developing country organisations and consultants, in recognition of the fact that much of the innovation in microfinance has been the work of people and organisations in developing countries.

As the money economy continues to spread, requiring the poor to pay for more and more of the services they require, access to lump sums to exploit investment opportunities, smooth consumption or meet emergencies will become increasingly pressing for increasing numbers of poor households. Microfinance is about expanding this access. The Australian aid programme will continue to play a significant role in supporting this expansion.

Notes

1. See Stuart Rutherford, *The poor and their money*, Oxford University Press, 2001.
2. In Rotating Savings and Credit Associations (ROSCAs), members meet on a periodic basis for as many times as there are members. At meetings each member contributes a fixed sum, with one member taking the full amount. The order in which the lump sum is taken can be decided by agreement, by lot or by auction. When the round is finished the group might start anew, re-form with some change of membership or disband. While an individual ROSCA is not permanent, the need for continued access to lump sums is met by a process of regular founding of new associations.
3. The CGAP is a microfinance donor grou p, comprising 29 member donors (including Australia) and a policy advisory group of experienced microfinance practitioners. Its secretariat is based at The World Bank in Washington. Its website (<www.cgap.org>) contains a wealth of material on microfinance, as well as links to other relevant sites. It also includes a link to the Microfinance Gateway, which includes an online library of microfinance literature.
4. An example of such an intervention is the Promotion and Capacity Building of Small Financial Institutions (ProFI) project of the German Agency for Technical Cooperation (GTZ) in Indonesia. ProFI focuses on developing/improving regulatory and supervisory tools primarily for the Bank Perkreditan Rakyat or Small Rural Banks (BPRs). The project involves the establishment of a deposit protection scheme for BPRs, the provision of training and the development of an accreditation process for BPR managers, a thorough review of current practices and tools of BPR supervision, and capacity building of the BPR umbrella body, Perbarindo.
5. A microfinance wholesaler provides training and/or loanable funds to retail microfinance organisations.
6. AusAID funding for RMDC and KASHF came in part from the Microfinance Seed Fund. The purpose of this three-year $A3 million fund, announced in the 1999–2000 Australian Government Budget, was to act as a catalyst for increased microfinance expenditure through the overseas aid programme. The 2001–02 financial year is the final year of the seed fund.
7. This issue of the *Development Bulletin* contains an article by KASHF's managing director, Roshaneh Zafar.
8. TFET, the Trust Fund for East Timor, is managed by the World Bank and the Asian Development Bank and receives funds from Australia, Finland, Ireland, Japan, New Zealand, Norway, Portugal, the UK, the USA, the European Commission, and the World Bank.
9. For example, C.A. Gregory, 'South Asian economic models for the Pacific? The case of microfinance', *Pacific Economic Bulletin*, 1999, 14(2).
10. An evaluation of the Qinghai Community Development Project, Quality Assurance Series No. 21, is available on the AusAID website (www.ausaid.gov.au/publications).
11. The best-known case of 'downscaling' is the Unit Desa system of Bank Rakyat Indonesia (BRI). There is a substantial literature on this, including Marguerite Robinson, *The microfinance revolution*, World Bank and Open Society Institute, 2001, vol. 3: *Lessons from Indonesia*; and Richard Patten, Jay Rosengard and Don Johnston, 'Microfinance success amidst macroeconomic failure: The experience of Bank Rakyat Indonesia during the East Asian crisis', *World Development*, 29(6), June 2001. However, questions remain about how far down the poverty scale BRI's units reach, and their inability to turn a large proportion of the deposits they mobilise into loans for the poor. See Detlev Holloh, *ProFI microfinance institutions study*, Bank Indonesia and GTZ, March 2001, 54–5.
12. The article by Jonathon Unger in this issue contains more information on rural credit in China.
13. *Reducing poverty: The central integrating factor of Australia's Aid Program*, April 2001, available from AusAID website or from Canberra Mailing Centre, PO Box 650, Fyshwick ACT 2609, (tel) 02 6269 1209, (e-mail) books@ausaid.gov.au.

Financing microfinance for poverty reduction

David S. Gibbons, CASHPOR

Microfinance has arrived

Microfinance is now recognised as an effective and financially sustainable tool for poverty reduction, particularly in developing countries but also for the poor in the developed world.[1] The Micro Credit Summit Campaign (www.microcreditsummit.org) has just announced that 30.6 million poor households around the world now have access to microcredit, and that the number covered increased by 40 per cent over the past year. This means that there is now an opportunity to bring about a substantial reduction of poverty around the world.

Microfinance is not a panacea for the elimination of world poverty, as not all poor households can make good use of it. Those without an able-bodied member to engage in income-generating activities cannot be helped out of poverty by a loan. Many other poor households do not have either the entrepreneurial ability and/or the self-discipline required to make good use of microcredit. But experience from all around the world now shows that substantial numbers of poor women provided with access to microfinance services are using the opportunity to reduce their poverty and that of their families.

In Bangladesh, the 'home' of microfinance and the country in which its outreach to the poor is greatest, we can estimate from the total outreach of microfinance institutions (MFIs) working with poor women, and the high loan portfolio quality that they are able to maintain, that at least 5 million poor women or about 50 per cent of all poor rural households are currently making good use of access to microcredit. If the women were not benefiting from the microcredit they would not be able to repay so consistently.

Fulfilling its potential

Our conservative estimate is that 40–60 per cent of poor women around the world could make good use of access to microcredit. But if microcredit is to be made available to them there will have to be major changes in its operating methods in order to attract sufficient funding. Efficiencies and major innovations to financing strategies will have to be made. Currently it takes too long for new MFIs to become profitable and, partly as a consequence of this, they are not able to attract sufficient finance to grow at optimal rates.

A fast-track methodology that can result in institutional financial break even within four years, as opposed to the historical average of six to nine years, is being successfully implemented by CASHPOR in India. CASHPOR Financial and Technical Services Ltd (CFTS) in Mirzapur, in eastern Uttar Pradesh, is four years old.[2] Institutional financial break-even is projected before the end of its fifth year of operation (end of September 2002), at which time it will be providing financial services to 25,000 poor, rural women who will have about rupees 7.8 crore (around US$1.6 million) loans outstanding in their hands, with less than 5 per cent of it at risk. At the end of September 2001, CFTS was reaching 16,283 poor, rural women who had rupees 4.0 crore loans outstanding, with a portfolio at risk of only 1.2 per cent.

The fast-track methodology is being developed in a replicable and franchisable 'unit' approach, in which scaling-up is carried out in units of ten or more branches, rather than the usual but much less effective one-plus-one strategy of branch development. Profits can be retained, a capital base built through retained earnings, resulting in the ability to leverage the funds required to facilitate growth from commercial banks.

Under the fast-track approach, the number of clients and branches needed to break even institutionally within five years is simulated through a spreadsheet, based on tested assumptions concerning group formation rates, loan size, portfolio quality, operating cost ratios and charging an appropriate interest rate. Then the required number of branches is established and fully staffed in Year 1, in order to maximise group formation which is the critical path to both poverty reduction and institutional financial break even.

However, because optimising efficiency through the fast-track approach requires heavy upfront investment, the financing of deficits and capital expenditure prior to break-even remains a formidable obstacle. As international financier George Soros put it recently (excerpted by the *Economic Times of India*, 23 October 2001, from his forthcoming *Report on globalization*): '. . . successful microlending operations, although largely self-sustaining, cannot grow out of retained earnings, nor can they raise capital in financial markets'. He also advises on what needs to be done to enable microcredit to play a significant role: 'To turn microlending into a big factor in economic and political progress, it must be scaled-up significantly. This would require general support for the industry, as well as capital for individual ventures.' Soros goes on to make some interesting specific suggestions as to how this could be done on a global scale, through the use of special drawing rights (SDRs).

However, as conventional equity is not available for financing MFI start-ups to profitability, and the proposal of Soros has not yet been acted upon, we must look for an unconventional method of financing microfinance if its great potential for poverty reduction around the world is to be realised.

The promise of quasi-equity

Many MFIs have utilised grants from supportive donors to get started in microfinance. Grants from international donors played a major role in scaling-up microfinance in Bangladesh to significant numbers of poor households. Since this funding is effectively 'free', start-up MFIs should of course try to maximise grant funding.

However, grant funding is not likely to be enough to cover deficits and necessary capital expenditure prior to institutional financial break even, even with the fast-track approach. Grants seem much harder to access and donors less generous with microfinance funds as they were in Bangladesh. It will be necessary now for start-up MFIs to rely more on equity-like financing instruments or, more appropriately, quasi-equity, such as loans and preferred investments designed to be repaid out of profits after break-even.

The soft loans must facilitate the attainment of break even. For this they must have terms that are long enough and grace periods, say six and five years respectively as minima, so as to be repayable out of profits; they should preferably have low interest rates, say 2–3 per cent; and they must be legally subordinate to other more commercial debt and not callable. The low interest rates help to minimise the cost of funds prior to break-even so as not to delay it. Legal subordination of these loan instruments to senior borrowings from commercial institutions is necessary for their qualification as quasi-equity rather than debt, thereby enabling MFIs to raise more commercial loans to finance onlending to the poor. Legal subordination means that these more commercial loans would get priority in repayment should the MFI be wound up. The lenders of the soft loans should not have the right to recall them prior to maturity, except in cases of default, otherwise the funding of the MFI may not be sufficient for break-even.

One technical problem with reliance on quasi-equity for financing deficits is that, while international standards for assessing the health of financial institutions, measured by capital adequacy[3], allow for inclusion of quasi-equity instruments in equity (the numerator), it cannot account for more than half of total equity. In other words, this Tier II capital can make up only 50 per cent of total capital, while the other 50 per cent must come from Tier 1 capital, pure equity, in the form of paid-up capital and grants. This means that fast-track MFIs would be able to rely on soft loans to finance only half of their deficits prior to break-even. While half would be a lot better than nothing, it might still not be enough for start-up MFIs utilising the fast-track approach.

Marking to market

This is where marking MFI debt to market could play an important role. There is a subsidy element in soft loans. It is the difference between the interest rate of the soft loan and the rate that MFIs would have to pay to borrow the funds commercially from the money markets. For example, if the interest rate payable on a soft loan is 2 per cent a year, and the money market rate for the same amount of funds is 14 per cent (not uncommon in poor countries), then the element of subsidy in the soft loan would be 12 per cent a year. Conceptually, it is the equivalent of a grant from the lender of the soft loan, and the MFI should get credit for this, capitalising it on the balance sheet as equity like any other grant. The market value of the loan is determined by discounting the cash flows during the loan term, both principal and interest, by the commercial rate of debt. The difference between the present-value of the debt cash flows and the amount of loan funding received is equal to the grant.[4] As the loan moves closer to maturity, the amount of the debt obligation will rise while the grant component declines.

The subsidy or grant element of soft, uncallable loans can then be placed on the balance sheet as part of Tier I capital each year. Together the Tier I and Tier II capital could then provide sufficient capital for financing fast-track deficits prior to institutional financial break-even *and* for leveraging from banks the onlending funds required. This is of great importance for the spread of outreach of microfinance to the millions of poor women around the world who could make good use of it to reduce their poverty and that of their families.

Sources of quasi-equity

Where would the quasi-equity come from? One thinks immediately of bilateral and multilateral donors interested in financing poverty reduction. However, bilateral donors are not used to extending loans; they prefer to give grants, as it is simpler.

Multilateral agencies like the World Bank, IFAD and the Asian Development Bank are used to dealing with loans. They could be a major source of quasi-equity for start-up, fast-track MFIs, and those that want to expand in 'fast-track' modules that can reach institutional financial break-even within four years. Development-oriented foundations like the Grameen Foundation USA, the Calvert Social Development Foundation, the Humanitarian Institute for Development Cooperation (HIVOS) and the Grameen Trust could also adopt quasi-equity as one of their main instruments for financing microfinance for the poor. National-level development banks could also play a role in the provision of quasi-equity to MFIs.

As the amount of soft loans required to finance MFIs to reach half of the world's poor women would be huge, it would be best to have microfinance funds at the national or regional level as well, especially in the poorer countries/regions, which could be financed by grants from bilateral donors and/or by very soft loans from multilateral lenders.

CGAP World Bank could play a critical role in building the institutional capacity of national and regional microfinance funds, in persuading its member donors to provide grants, and in monitoring and evaluating the performance of the funds.

Notes

1 'Microfinance includes microcredit, saving facilities, insurance cover and any other financial services provided by MFIs.

'Microcredit' refers only to small loans. See the chapters by Gibbons et al. in *Microfinance and Poverty Alleviation*, Joe Remenyi and Ben Quinnones (eds) 2000, Pinter, London.

2 Although CFTS is a Grameen Bank-type MFI, group formation rates are the critical path for all solidarity group approaches

3 Capital adequacy is defined as equity divided by risk-adjusted assets, with a minimum level of 8 per cent.

4 I am indebted to Jennifer Meehan, microfinance consultant, for bringing to my attention the relevance of present-valuing to the financing of microfinance. Jennifer and I are preparing a paper for the Micro Credit Summit +5 to be held in New York on 10–13 November 2002, which will develop the ideas in this article more fully. However, she is not in any way responsible for any misuse to which I have unintentionally put the concept of present-valuing here.

Relative system risks to the savings of poor people

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Background

Increasingly microfinance institutions (MFIs) have come to recognise the need to provide savings services, both as a much-valued service to their clients, and as a long-term source of capital. This has led to growing interest in savings, Vogel's (1984) 'forgotten half' of microfinance. As a result of the new attention to savings services, a great deal of time and energy is being spent by central banks, donors, consultants and MFIs on developing systems for regulating and supervising MFIs offering savings services.

The motivations of central banks typically include regulation of MFIs (or indeed any other financial institution) and revolve round two primary aims:

- to protect the integrity of the country's financial system (that is, to guard against systemic risk); and
- to protect depositors within a context of asymmetric distribution of information (that is, to guard against depositors losing their savings in the event of the failure of financial institutions).

In most countries, with the exceptions of Indonesia, Bangladesh and possibly Bolivia, MFIs simply have not reached the scale or achieved the breadth and depth of market penetration to pose any systemic risk. It is therefore the laudable desire of central banks to 'protect depositors' that is the credible rationale for their efforts to regulate and supervise.

Poor people have limited access to formal or semi-formal financial services. They therefore lack formal financial service alternatives to the MFIs. If MFIs are prohibited from offering savings services to poor people, those poor people are forced to resort to the informal sector in order to save.

It is clear, and now generally accepted, that poor people want to, need to and do save. There is also increasing evidence that they are facing an extremely risky environment when they save in the informal sector. Thus, it is clear that, when discussing the risk to poor people's savings, this has to be evaluated on a relative basis. Very often all the alternative savings systems available to poor people are risky, so they are left facing decisions on the relative risk, or relative security/safety, of the various semi-formal and informal savings systems open to them.

In light of the above, MicroSave-Africa decided to build on its existing qualitative research data and experience in this area by commissioning additional focused qualitative work and an extensive quantitative survey to be conducted by an international market research company, Research International.

Research objective

The primary objective of the survey was to quantify the relative risk faced by poor people as they save in the formal, semi-formal and informal sectors. More specifically the following questions were addressed:

- What formal, semi-formal and informal savings systems/services do the poor use, if any?
- How much money have the poor saved in various systems in the past one year?
- How much money have they lost within the one-year period in the various systems?

Methodology

MicroSave-Africa has an extensive qualitative data set comprising over 500 group interviews, with groups averaging 6–8 people, 200-plus individual in-depth interviews, 19 focus group discussions and associated participatory rapid appraisal exercises explicitly designed for this study. For the purposes of this study this data set was augmented by a 1,500 person survey based on face-to-face interviews among adults in Central, Eastern and Western Uganda. The survey was conducted by an independent private sector market research group.

As with all quantitative surveys involving financial affairs, the data gathered have to be treated with care. For a variety of reasons, people under- or overstate financial transactions, in this case savings or losses. In other cases, as a result of the very nature of the savings systems used, particularly those with on-going arrangements such as functioning burial funds or Accumulating Savings and Credit Associations (ASCAs) or Savings and Credit Co-operatives (SACCOs), it was difficult for respondents to know if they had lost savings or to estimate exactly how much they had really lost because of lack of reporting or documentation sent to clients by these agencies. Finally, when discussing savings, it is always important to differentiate 'stocks' of savings from 'flows' of savings. This survey sought to focus on the process of saving – that is, the amounts people saved in the various systems as opposed to the stocks of savings held there. Despite this, there is a risk that some respondents were discussing their stocks of savings in the various systems.

To mitigate these factors and to bring a depth of understanding to the issues, we relied on:

- a carefully and sensitively designed, pilot-tested and administered questionnaire and professional interviewers from an international market research company;

- the extensive data set from MicroSave-Africa's work on savings in Uganda over the last two years; and
- qualitative research designed explicitly to explore these types of issues.

Results

Losses – the big picture

The research revealed that 99 per cent of clients saving in the informal sector report that they have lost some of their savings, 15 per cent of those saving in the formal sector report that they had lost some savings, and 26 per cent reported lost savings in the semi-formal sector. Thus, the formal sector, for those lucky enough to have access to it, is safer both in terms of likelihood of losing any savings and in terms of the relative loss (amount lost to amount saved). Those with no option but to save in the informal sector are almost bound to lose some money, probably around one-quarter of what they save there.

People who have access to the formal sector reported saving three times as much (US$386) in the last 12 months as those in the semi- and informal sectors. Those in the formal sector also reported a lower incidence (15 per cent) of loss and a lower rate (3.5 per cent) of loss in the last year. Almost all (99 per cent) of those saving in the informal sector reported that they had lost some money through informal savings mechanisms and, on average, had lost 22 per cent of the amount they had saved in the last year.

Losses in the formal sector

Fifteen per cent of those who saved in the formal sector (for example, commercial banks, pension funds) had lost savings in this sector during the last year. On average, they had lost around Ush.18,000 (US$11) or 3 per cent of the average Ush.618,000 (US$386) saved during the year in this sector. The surprisingly high rate of loss among formal banks – ostensibly covered by the Bank of Uganda's deposit insurance scheme – is likely to have arisen amid the confusion surrounding the closure of the Co-operative Bank during the year. Several respondents had experienced problems trying to recover their savings from this bank. Either the balances verified as payable by the bank were substantially below those the clients had entered in their passbooks or the process of retrieving their savings was so lengthy (requiring multiple trips to the bank premises) that it effectively wiped out what little savings they had.

Losses in the semi-formal sector

Twenty-six per cent of those who saved in the semi-formal sector (for example, MFIs, SACCOs)had lost savings in this sector: on average, around Ush.19,000 (US$12) or 9 per cent of the average Ush.210,000 (US$131) saved during the year. Fourteen per cent of the total sample had saved with an MFI during the previous year, and of these 90 per cent had saved with an MFI using a group-based system. Within these, there is an apparently high (27 per cent) incidence of savings lost among MFIs using group-based methodologies. However, the average amounts lost (7 per cent of savings made during the year) are relatively low. Most of the loss experienced with group-based MFIs appears to have been as a result of the group guarantee system and members' savings being used to 'balance out' the loans of defaulting group members.

Losses in the informal sector

The losses in the informal sector (for example, in kind, at home, savings clubs, Rotating Savings and Credit Associations (ROSCAs), ASCAs) are characterised by a very high incidence and a highly variable extent of loss as a percentage of the amount saved. It is interesting to note that the most risky forms of saving are the most popular: savings in kind and at home are the most commonly used and they experience the highest rates and levels of loss in absolute and relative terms.

Savings in kind is the most important form of informal savings: 82 per cent of the sample had saved money in kind, an average of Ush.434,000 (US$271). Of all the informal savings systems, savings in kind was the most popular and attracted the largest amount of savings: respondents saved similar or greater amounts only in formal sector financial institutions.

Sixty-eight per cent of the sample had saved at home in the last year and all of these had lost some of their savings: on average, Ush.38,000 (US$24) or 26 per cent of the average amount they had saved during the previous 12 months. In 45 per cent of cases, the loss had been due to the respondent's own or their family's petty spending, 27 per cent had lost due to the demands of friends and relatives for assistance and, in 13 per cent of cases, savings had been stolen.

Many poor people set up reciprocal arrangements whereby they save by lending. Lending to a neighbour or relative today sets up a reciprocal arrangement under which the neighbour or relative will lend back tomorrow in times of need. Reciprocal lending as a form of saving has another advantage: the money is out of reach of marauding husbands and relatives and the temptations of trivial spending, and is typically only returned in times of real emergency. In the study's sample, 41 per cent of respondents had saved through reciprocal lending arrangements. However, this is clearly a risky form of saving: it depends on the goodwill and liquidity of the neighbour or relative. With a loss rate of 69 per cent in the sample, clearly the goodwill/liquidity is not always available.

It is noticeable how relatively few (23 per cent) had participated in ROSCAs in the last 12 months. In addition, they had saved relatively small amounts: on average, Ush.139,000 (US$87) or Ush.2,700 (US$2) a week. Given the simplicity and reputation of ROSCAs, some might be surprised at the relatively high proportion (27 per cent) of users who had lost money.

Discussion and conclusions

What it means for central bankers

It is clear that commercial banks, and the few larger MFIs that have transformed into a status that brings them under the supervision of central banks, will never be able to reach out to offer savings services to poor people in remote rural areas. Indeed, with the increasing closure of rural commercial bank branches throughout Africa, the trend is the reverse. Some creative thinking and flexibility are therefore required in order to address this issue. It is not good enough to say, 'We cannot guarantee the security of your deposits at unsupervised institutions, so you cannot save with them' – this simply drives people into, or strands them in, the highly risky informal sector.

For too long, central bankers have seen depositor protection in absolute terms. The experience of many Uganda Co-operative Bank clients demonstrates that absolute depositor protection is largely unattainable. More importantly, when considering 'safeguarding the deposits of the poor', it is essential to think in terms of relative risk rather than absolute risk. In the same way that rich people make investment and savings decisions on the basis of the relative risk and return of the variety of opportunities available to them, so poor people are constantly faced with the need to assess the relative risk of the limited options they have to save.

What it means for the microf inance industry

Most would agree that smaller MFIs are risky institutions to which to entrust savings. However, as can be seen from the analysis above, on a relative basis many are likely to be far safer than the most common informal mechanisms that the poor are forced to use by policies that prohibit MFIs from mobilising savings. In addition, savings services play an important role in the management of business and household affairs and many poor people would be delighted to take the risk on a small MFI surviving for a few years and providing a useful service.

To date, few central banks or microfinance gurus have given adequate thought to how best to improve the security of poor people's deposits held in smaller MFIs – most seek to provide this security by simply prohibiting these MFIs from providing savings services at all. This ignores the needs and demands of the MFIs' clients. Furthermore, particularly in remote rural areas, community-based, user-owned and user-managed systems are likely to be the only sustainable way of delivering financial services to the poor living there. To seek to regulate them out of existence will simply drive this potentially important sector of the rural finance industry underground – out of reach of the very training and technical assistance programmes that might have strengthened the institutions and protected the deposits many of them are likely to take anyway.

This is not to suggest that no efforts should be made to identify and close down semi-formal institutions that are deliberately seeking to defraud poor people of their savings. However, it is necessary to recognise that ill-considered, draconian prohibition of deposit mobilisation: *neither* prevents such institutions starting up in areas where there are no, or limited, formal/semi-formal alternatives for poor people – for example, most of rural Africa – *nor* protects poor people's savings but instead forces them into, or strands them in, informal systems with a high relative risk.

In view of the highly risky nature of saving in the informal sector, it is probably necessary to think more about helping clients to understand the relative risk of saving in these semi-formal institutions. It should also be noted that the evidence from this study suggests that poor people do value some form of external accountability. Clearly, this type of accountability increases the trust of poor people in the institution and thus facilitates the institution's savings mobilisation activities. Serious semi-formal sector MFIs should therefore want some form of external accountability.

In the first instance, it is important to improve internal supervision, including accounting systems, internal control, governance, and adequate transparency to allow members to make their own decisions about the risk associated with saving in the institution. At the same time the microfinance industry has to search for alternative and appropriate approaches to external supervision, probably a voluntary system based on decentralised, non governmental bodies. This is an area that the industry has scarcely begun to address, and one that warrants a great deal more attention in the future.

That said, poor people cannot wait for the perfect system to protect their deposits. Indeed, the evidence from the formal commercial sector demonstrates that this panacea does not exist. In the short run, it may be preferable to give poor people the choice. We must, however, seek to inform that choice so that they can make their own decisions about the options available to them and the relative risk of each.

References

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Including the excluded: Lessons learned from the poverty-targeting strategies used by microfinance providers

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Introduction

The Micro-Credit Summit convened in Washington DC in 1997 brought together practitioners in non government, government and private sectors to discuss the potential of microfinance to combat poverty. Representatives at this Summit set an ambitious goal: access to credit for 100 million of the world's poorest families by the year 2005. Though controversial, this goal set in motion a rapid expansion of the microfinance industry, much of it driven by donor agencies who established goals for targeting the poor for their services. Consequently, in 1998 the Coady International Institute, under the auspices of the Consultative Group to Assist the Poorest (CGAP), collected information on the poverty-targeting strategies of 25 microfinance providers around the world and summarised the data in a compendium for use by practitioners in the microfinance field.[1]

This article examines the strategies employed to target the poor and provides an analysis of how they differ, depending on the mandate and the development paradigm of the provider. Examining the context of microfinance service provision is useful for understanding trends in poverty targeting, especially the current pressures for organisations to demonstrate financial self-sufficiency. On the one hand, the goal of achieving a broader outreach to the poor seems to strain against the goal of financial self-sufficiency (Otero 1994). On the other hand, the achievement of such self-sufficiency is seen by others (Accion International 1998, Seibel 1998) as essential for sustainable and cost-effective poverty reduction.

The relevance of this debate on poverty targeting is analysed by examining the research conducted for the compendium. The contributions illustrate how different targeting *methods* combine to form particular *strategies* that are in tune with the mandate and rationale of each microfinance provider. These contributions imply that a narrow view of the costs and effects of targeting is of limited usefulness when considered in isolation from the added-value of targeting, and the non-financial services that may accompany microfinance service delivery.

The context

Microfinance service delivery has been promoted as a key strategy for reducing poverty, as well as for stimulating sustainable economic growth through self-employment and small enterprise development. Access to these facilities is assumed to provide the poor with the means to cushion themselves against economic shocks, to attain self-reliance through entrepreneurship, and to achieve social empowerment. Non government organisations (NGOs) have been active promoters of this strategy, acting locally in the delivery of microfinance services, while simultaneously participating in the global debate about the possibilities for, and implications of, integration of these services into the commercial banking sector.

This debate is rooted in paradigmatic differences, couched in terms of 'the need for economic efficiency' versus 'the need for social equity' (Dunford 1998:2), 'market-led growth' versus 'poverty alleviation' (Kantor 1998:3), or the 'financial market paradigm' versus the 'directed credit paradigm' (Vogel and Adams 1997:361). These in turn have informed heated discussions about the relationship between the financial self-sufficiency of the microfinance industry and its outreach to the poor, particularly the poorest. Thus, although the financial market paradigm proponents argue that only financially sustainable providers can maximise outreach on an ongoing basis (Accion International 1998, Seibel 1998, Vogel and Adams 1997), supporters of directed savings and credit – often with additional services ('credit plus') – argue that such a market-driven paradigm fails to provide the poor with the skills and resources required to ensure sustained impact (Dawson and Jeans 1997).

The debate on outreach versus impact and efficiency

Under scrutiny are two issues: the extent to which microfinance services have reached the poor clients for whom they are intended; and the impact that such outreach is likely to have. An important distinction is that, although microfinance programmes may have the social objective of reducing poverty, the intention of many is to achieve this by targeting not the poorest of the poor, but the poorest of the economically active. Many of these potential clients could fall into the category of the bottom 50 per cent of those whose income is below the poverty line ('the poorest of the poor' by CGAP's definition), but the microfinance provider rarely targets the full range within that category or restricts services exclusively to it. This caveat aside, various studies now indicate the limited extent to which providers that intend to reach the poorest are able to do so (Hashemi 1997, Hulme and Mosely 1996, Mosely and Hulme 1998, Seibel and Parhusip 1997).

On the issue of impact, Gulli (1998) points to the synergy effects of financial service outreach and other services and supports.

Without this synergy, the positive impact of access to financial services may be hard to realise. Also, to examine the impact of targeting strategies without an appreciation of the institutional context of microcredit delivery can be dangerously short-sighted. Targeting the poor shifts attention away from the broader benefits of member/client-owned institutions. These have 'a much more holistic view of community and are much less focused on selective (and in many cases artificial and divisive) targeting'.[2]

When the donors of microfinance providers fund programmes on the understanding that the poor are being targeted, and are benefiting, the question arises of how the providers target the poor. The effectiveness and value-added dimension of these strategies become a subject of keen interest. The poverty-targeting strategies documented in the compendium shed light on this question.

The compendium of poverty-targeting strategies

With the collaboration of CGAP working group members, information on poverty-targeting strategies was solicited from 35 microfinance providers. The 25 institutions that responded employ a range of strategies in 20 different countries in Asia, Africa, Latin America, and the Middle East. These different strategies are presented in the compendium on an institution-by-institution basis, illustrating the choice of strategy in the context of the provider's mandate, its rationale for poverty targeting, the additional benefits associated with that strategy, and the challenges faced in its application.

Of the 25 providers, 15 are non profit organisations implementing microfinance programmes only, 5 are non profits with multisector programmes, and 3 are for-profit institutions. Two are special cases: DID in Mali is a non profit arm of the credit union Desjardins; and Trickle Up is a non profit which provides savings services and small grants (not credit) in Guatemala. Despite solicitations, we were unable to collect information from government-backed schemes (such as Bank Rakyat, Indonesia), or to increase the number of contributions from the commercial sector.

The rationale for poverty targeting

The term 'targeting' has been associated with *delivering* a particular service or intervention to an identifiable set of clients. For this reason, contributors were encouraged to view their methods of *attracting* particular clients as targeting methods, equally relevant as methods of identifying and reaching clients in more conventional targeting approaches. From these contributions, five elements of a poverty-targeting strategy become clear: identifying the poor; reaching the poor; attracting the poor; excluding the non-poor; and discouraging the non-poor. Thus, the rationale for poverty targeting can be expressed in three broad categories:

- It is justified on the grounds of equity: For all respondents, there is an underlying moral imperative expressed as a desire to help those in need; to enable the poor to break out of a poverty trap induced by drought, civil war and neglect; to alleviate extreme poverty; to restore dignity to a segment of the poor who are exploited and impoverished; to reverse the process of marginalisation of the poor, particularly in the face of the impact of structural adjustment programmes; and to empower poor women. In other words, the rationale is in the redistributive paradigm of including the otherwise excluded.
- It is essential for broad-based development: In the case of Grameen Bank and its replicas, the rationale for stringent targeting of the poor is that broad-based social and economic development cannot occur unless poverty is reduced. The Association for Social Advancement (ASA), Bangladesh, expresses a similar sentiment: 'Social development is contingent upon economic emancipation'. Targeting is seen therefore as a way of mobilising the poor through incremental savings and credit so that they can contribute to, and benefit from, a growth economy.
- It is a way of ensuring high repayment rates: Exclusive targeting of the poor may also have a financial rationale. Because the poor are more likely to accept the discipline required of participating members, the microfinance provider can expect a good repayment rate (Grameen, Bangladesh) if the poor are actively targeted. The reliability of poor women in terms of loan repayment is cited as an additional reason for a gendered targeting strategy (Kalanjiam, India).

Methods of poverty targeting

The poverty-targeting strategies of most of the 25 microfinance providers include all five complementary targeting components. It is important to recognise that, although some providers may emphasise one component over another, to a greater or lesser extent all components are combined to achieve maximum effect. Also, some providers use different targeting strategies depending on the local economic and social circumstances, as documented by Friends of Women's World Banking (1998), for example in the case of Kalanjiam. Note that some providers, especially those which are oriented to a financially self-sustaining operation, do not target the poor exclusively but endeavour to include a mix of non-poor and poor and to provide customised financial services.

Identifying and reaching the poor

The first stage is identification of the geographic areas in which poverty is concentrated. The use of government statistics, for example, can enable the microfinance provider to identify areas as extensive as the Northern Areas and Chitral of Pakistan, or as limited as pockets of poverty in the West Bank of Palestine, or in metro Manila in the Philippines. At a higher level of precision are methods requiring local and subjective identification, or the use of objective indexes to both identify the poor and simultaneously exclude the non-poor.

Local and subjective methods include the identification of the poor by their peers who are forming, for example, a savings and credit group (CRS, CAM, ASA). Eligibility criteria may be set down by the microfinance provider for use by community members to identify candidates for group membership (for example, the criteria prescribed by ASA are landlessness, income of less than $US45 per year, capability to work in income-generating activity, married status, and female gender). Typically, judgements of eligibility are made not just on the basis of poverty status, but also on criteria unrelated to poverty, such as trustworthiness ('character referencing'). Also in this category are participatory wealth ranking methods by which reference groups in the target communities rank households according to their relative wealth on the basis of community-defined poverty/wealth criteria. SEF in South Africa and Kalanjiam in India are proponents of this approach.

Objective indexes identify the poor by employing criteria applicable across different sites and are typically administered by field staff. Examples of these are the housing index (DECSI, SHARE, Project Dungganon, Nirdhan, AIM) and the poverty assessment tools administered by Trickle-Up, using locally determined, observable characteristics of poverty. The next level of precision, if required, is the means or assets test that serves to both confirm eligibility and to identify the precise degree of poverty.

Identification of the poor has to be combined with active outreach for targeting to be effective. The promotion and encouragement of eligible clients by fieldworkers are standard practice. For example, house-to-house promotion, community meetings, outreach to existing informal women's groups, the employment of female staff, and the facilitation of their fieldwork are all promotional strategies that are an integral part of the targeting process, and are a conscious policy of the microfinance provider (see Baydas et al. 1997 in relation to the commercial banking sector).

Attracting the poor

Another aspect of targeting is when the customised design and marketing of financial products attract the target group to the provider. This self-selection is a key component in any targeting strategy and takes the form of removing constraints so that the poor select themselves as clients.

Microfinance providers attract the very poor and the poorest by removing the constraints that have deterred them from using commercial financial services. They may be attracted by the opportunity to save voluntarily, to take out a small-sized loan or to borrow for 'non-productive purposes' in times of crisis, or by the opportunity to purchase insurance. They may also be attracted by the security that group-lending schemes provide. A case in point is AKRSP where individuals can only borrow against their savings, thus protecting other members in the village organisation (which takes out a group loan) from default by an individual borrower. The poor may also be attracted by the fact that group guarantee schemes replace the collateral that women, in particular, are unable to provide, the simplicity and convenience of application procedures, the size and types of loan available, and the flexible repayment terms. TSPI, for example, takes customised lending to the point of targeting a very particular client group: their 'fixed asset loans' are strictly for street vendors for the purchase of a bicycle.

Discouraging or excluding the non-poor

Although a diversified clientele and diversified portfolio are characteristic of many microfinance providers, others have found that the participation of the non-poor in a microfinance programme discourages the poor from participating for reasons of low self-esteem.[3] Programmes that encourage self-selection by the poor are often complemented by measures to discourage the non-poor:

- Self-exclusion: Small loan size, high interest rates, and high opportunity costs of frequent group meetings are ways in which the provider screens for a client's level of commitment and her or his opportunities to access alternative financial service options. In most instances, the non-poor do not tolerate the high financial costs and the time commitments (transaction costs) of group meetings. In some situations, however, these measures are not sufficient; for example, SEF found that where the availability of credit is very limited, the non-poor were prepared to tolerate small loans and frequent meetings in the hope of eventually graduating to bigger loans in subsequent loan cycles.
- Eligibility criteria: Some eligibility criteria are sensitive with respect to including the poor, whereas others are more specific and exclusive of the non-poor. For example, gender and geographic criteria can allow inclusive targeting of the poor, but they are not specific to the poor and exclusive of the non-poor. Observable housing characteristics and minimum poverty or income levels are examples of criteria that have this specificity. As a result, it is possible to exclude the non-poor on the basis of tools using these types of criteria.

Combining methods to form a targeting strategy

Typically, the microfinance provider combines a number of different methods to form a unique poverty-targeting strategy. Three cases illustrate this point.

AIM, Malaysia, is a specialised microfinance provider. First, the area of highest density of poverty is identified using government statistics. Second, trained field staff apply a housing index, followed by a means test to exclude the non-poor. During this time, the purpose of the programme and the microfinance product features (customised to poor clients) are promoted to attract the poor.

Eligible members are invited to form a savings and credit group and are provided with training.

AKRSP, Pakistan, is a multisectoral NGO. First, an area of widespread poverty is selected for a multisectoral programme, for example 'the Northern Areas' of Pakistan. Village organisations are promoted as a mechanism for community development, with separate organisations promoted exclusively for women. Savings and credit programmes operate through these organisations, which act as the contact point for all AKRSP's programmes and services. People are attracted to the savings and credit programme because of the group insurance, the opportunity to save and to borrow very small amounts, and the availability of loans for non productive as well as productive purposes. The groups have significant discretionary power over issuing loans, as long as the overall operations of the savings and credit groups operate within stipulated guidelines. Over time, AKRSP introduces a more diversified range of financial products to cater to an increasingly diversified client market. At the same time, it extends its geographical outreach to start the process again.

SEF, Southern Africa, is a microfinance and small enterprise development. It had originally used an objective index (the Visual Indicator of Poverty Test) to identify the poor, combined with product design features such as high interest rates and small initial loan size, to discourage the non-poor. Realising this method of identification was not accurate and that the disincentives to the non-poor were not effective, poverty targeting was redesigned. In the new strategy, a participatory wealth-ranking exercise is conducted within the target area. Not only has this yielded more accurate results, it has also provided an opportunity for awareness raising and motivation.

Targeting costs and benefits

The main intention of targeting is to increase usage of the organisation's services by those most in need. However, the process can increase operation costs; the benefits of value added and effectiveness of efforts can contribute to an analysis of the cost/benefits.

Cost considerations

Cost considerations are important for several reasons. First, of targeting influence the degree to which the provider can achieve financial self-sufficiency, either because of the costs of poverty identification and outreach, or the transaction costs of administering small savings and loans, or both. Second, the costs of targeting the poor vary. Should the provider serve as many poor people as possible for the least cost (where infrastructure is in place, for example), or spread itself thinly in more remote areas, or work more intensively and over a longer period of time with the hard-core poor?

Respondents in our study noted a number of ways in which costs had influenced their targeting strategy. The cost of staff time to administer poverty identification tools was frequently mentioned. Project Dungganon, for example, has simplified its housing index for routine screening and now uses a means test only in the third and fifth borrowing cycles. The costs of reaching remote areas were also taken into account – ASA, for example, explicitly restricts its operations to areas where there is adequate infrastructure.

In contrast, Grameen Bank points to the costs of *not targeting*. This argument rests on the assumption that non-poor clients are less reliable because they are less desperate for the service and therefore a greater risk in terms of repayment. Their participation thus threatens the financial viability on which the poor depend. Other contributors draw attention to the leakage if resources designed for the poor are diverted to the non-poor, especially in donor-subsidised programmes. Several NGOs that apply targeting strategies that exclude the non-poor are particularly concerned about potential leakage.

Value-added considerations

Contributors to the compendium were asked to consider the additional benefits of their targeting strategy. Several were mentioned:

- Community empowerment in cases where participatory methods for identifying the poor were used. In the case of SEF and Kalanjiam, an additional outcome of the targeting process was a sense of ownership of the programme and a greater appreciation of its purpose.
- Empowerment of women, which simply by targeting them is an affirmation of their importance.
- The enhanced effectiveness of programmes can result from a more precise understanding of local perceptions of poverty (SEF, Kalanjiam, Trickle-Up).
- The use of data collected for targeting can be used as baseline data for future impact studies (CAM, FINCA, KMBI, SHARE).
- The contribution the targeting process makes to other components of a multisectoral programme can be useful (AKRSP).

Effectiveness considerations

Effectiveness of targeting implies the degree of success in reaching desired group of persons. Although effectiveness data are hard to verify, contributors estimated effectiveness by indicating the number of clients who fall into the 'poorest of the poor' category at the time of their first loan. AKRSP was exceptional in also being able to estimate its extent of coverage by indicating the proportion of potential clients actually served.

Weighing the costs and benefits

Contributors were not asked to explain precisely how costs and benefits were weighed; however, the patterns that emerge from the data are worthy of further investigation. While all contributors are to some extent influenced by pressures to achieve financial self-sufficiency and to be cost effective in their targeting, there is less pressure when programmes are less mature and when the mandate of the organisation is both to focus on the poorest and to provide additional complementary support services. In many cases, the costs of targeting for the microfinance sector are difficult to separate from routine outreach of various services. Also in question are the criteria for effectiveness. The effectiveness of targeting can be measured by the proportion of clients reached who fall into the target category, but such a measurement does not give an indication of coverage – the proportion of the total potential of the target group who access the service. Where targeting practices are an integral part of service delivery (informing clients, helping them to participate in targeting, forming groups, providing educational services) the more appropriate questions might be: how does targeting contribute to more effective programme delivery and sustained impact? How does this get included in the costs/benefits ratio?

Conclusion: What kinds of providers do what kind of targeting?

Differences in poverty-targeting strategies appear to depend on how much pressure there is for microfinance service delivery to be financially self-sufficient, and also on whether it is one of several complementary services.

All contributors in the compendium research used a combination of methods, leading me to conclude in an earlier report (Mathie 1998: xiv–xv) that 'targeting has as much to do with tailoring products to suit the client market as it does with identifying who is and who is not eligible for services'. Further analysis, however, reveals two broadly different orientations:

- Targeting-plus (borrowing from, and complementary to, the expression 'credit-plus'): Here targeting is integrated with programme delivery. CREDO, for example, has targeting and training going on simultaneously, as do others using the group solidarity approach to microfinance provision (such as MEDA, CAM, and the Grameen replicas). Depending on how it is defined, targeting is seen as low cost because it is built into the costs of delivery, or a cost that is justified by the additional benefits it brings to service delivery (enhanced group solidarity, enhanced appreciation for the programme, enhanced understanding of the precise nature of poverty). Typically, providers using this approach are operating in the redistributive paradigm of directed credit; they assume that financial services by themselves are not sufficient to enable the poor to move out of poverty.
- Targeting by attraction: Here the marketing model predominates. Products and services are designed to attract clients to the provider. These methods are less intrusive and less costly; they are favoured by providers committed to the financial market paradigm. Although more active targeting methods are also used, the main emphasis of the strategy is product design: products are customised to different client markets, and through such diversification, a self-sufficient system operates. Providers favouring this approach are more likely to be client-owned providers such as SANASA and DID, or those NGOs approaching financial self-sufficiency. AKRSP is one example of a provider using this approach; it is an NGO operation that is now close to being fully integrated with the commercial banking sector.

The costs of targeting by attraction may be less; however, some researchers (Dunford 1998, Otero 1994) raise concerns that outreach may be compromised by such a market-driven approach. The concerns are related not only to the special financial services (such as savings and insurance services) that the very poor require over a long period of time until they are confident enough to take credit, but also to the training and educational activities characteristic of targeting-plus that may have to be carried out by other programmes and service providers. Such piggybacking may be formalised within a programme or between two programmes. AKRSP, for example, successfully fosters group organisation and management of economic development by the target group, while stimulating the growth of a sustainable, inclusive (catering to both poor and non-poor) financial system integrated into the commercial banking sector. An example of collaboration between two agencies, one non profit and the other commercially oriented, is the relationship between DID and FFH in Mali. DID uses credit-product design to attract the poor, which is complemented by FFH's outreach, training and education programme.

Clearly, the rationale for a particular strategy is influenced by assumptions about the dynamics of economic and social change that underlie the design of each provider's policies and programmes. According to Ruttan (1998), there is still debate on the particular relationship between poverty alleviation, sustainable economic growth and income distribution, and the conditions under which a financial system can be extended without prejudice or further damage to the poorest of the poor. Moreover, challenges continue to be made to an economic paradigm in which income, rather than a composite quality of life index, is the dominant indicator. Nevertheless, whether the poor are seen as a market niche or as the casualties of an exploitative financial system, the conclusion suggested by the compendium contributions is that they will continue to need more than financial services for there to be a sustained impact. The targeting strategy is therefore no longer an additional cost to financial service delivery, but value added to the successful delivery of services.

The question remains as to who will bear this cost, and this will depend on external social and economic conditions as much as on microfinance provider policy. The bottom line is that, ultimately, effectiveness has to be measured in terms of the sustained impact of financial services on the livelihoods of the poor, including the poorest. The contributions to the compendium imply that this cannot be achieved by delivering financial services alone, however accurate the targeting strategy.

Notes

1. The Coady International Institute was funded by the Canadian International Development Agency (CIDA) to work on this study in collaboration with the CGAP Working Group on Poverty Yardsticks and Measurement Tools.
2. Anthony Scoggins, pers. comm., June 1999.
3. Hashemi (1997:253) notes that the hard-core poor 'self-select' themselves out of the Grameen Bank schemes because 'they are so destitute that they consider themselves not credit worthy'.

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Acronyms

AKRSP	Aga Khan Rural Support Programme, Pakistan
AIM	Amanah Ikhtiar Malaysia, Malaysia
ASA	Association for Rural Advancement, Bangladesh
BRAC	Bangladesh Rural Advancement Committee, Bangladesh
CAM	Centro de Apoyo a la Microempresa, El Salvador
CGAP	Consultative Group to Assist the Poorest
CIDA	Canadian International Development Agency
CREDO	Christian Relief and Development Organization
CRS	Catholic Relief Services
DECSI	Dedebit Credit and Savings Institution, Ethiopia
DID	Developpement International Desjardins, Mali
FINCA	Finca, Ecuador
FFH	Freedom from Hunger Foundation, Ghana
Grameen	Grameen Bank, Bangladesh
IPMF	Ibn Khaldoun People's Monetary Fund, Egypt
KMBI	Kabalikat Para Sa Maunlad Na Buhay, Inc., Philippines
Kalanjiam	Kalanjiam Foundation, India
KWFT	Kenya Women's Finance Trust, Kenya
MEDA	Mennonite Economic Development Associates, Nicaragua
NWTF	Negros Women for Tomorrow Foundation (Project Dungganon)
Nirdhan	Nirdhan, Nepal
Sanasa	SANASA, Sri Lanka
SC/USA	Save the Children, Palestine
SEF	Small Enterprise Foundation, South Africa
SHARE	Society for Helping and Awakening Poor through Education, India
Trickle-Up	Trickle-Up, Guatemala
TSPI	Tulay Sa Pag-Unlad, Inc., Philippines

Poverty, credit and microcredit in rural China

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China has put in place a government-organised programme of credit for farmers. Despite this, a very large number of farmers are caught without any access to loans to purchase the agricultural inputs they need. For many, this lack of credit is one of the major factors that keep them trapped in poverty. In light of this, the government agency responsible for poverty alleviation has sponsored an additional credit programme that provides a type of Grameen Bank microcredit. Yet this is not well suited to poor villages that rely upon agriculture.

The usual Chinese system of rural loans

In Mao's day, during the period of collective agriculture, each rural market town contained a government-owned credit association. When the collective fields were divided up among households in the early 1980s, these credit associations became the main source of loans to support the individual families' farming. They initially gave priority to providing credit of 3–12 months' duration to enable families to buy agricultural inputs at the start of the growing season or to buy animals for fattening and quick resale or to tide a family breadwinner over a sudden illness.

In particular, many poor farmers today require loans to purchase chemical fertiliser, which is desperately needed in the very infertile soils of most of China's impoverished areas.[1] The extensive household interviewing that I conducted in the poor hill country of the southwest revealed a doubling, or in some cases even a tripling, of grain output by families who could afford sufficient fertiliser, in comparison to neighbours who did not use any. A vital reason is that the improved grain seeds now on the market depend upon sufficient soil nutrients, and thus fertiliser use has become the dividing line between households that are able to upgrade to the high-yield varieties and those that cannot. Access to a loan to purchase fertiliser is often the difference between development and hunger.

The credit associations, however, have come under strong pressure from the state to be business-like in their loan policies. They therefore normally reject poorer households' requests on the grounds that repayment cannot be guaranteed, as the families do not possess collateral. An applicant's residence and the fields that had been allotted to the family do not count as collateral since evictions are next to impossible.[2]

This policy of non-eviction is praiseworthy, since it protects rural families from descending into the status of landless labourers. But it also means that they need to fall back on draught animals or pigs or other movable assets as their collateral. However, impoverished families do not have the wherewithal to raise such animals precisely because they lack fertilisers and therefore cannot grow enough to feed themselves, let alone livestock. Overall, in the three dozen impoverished villages that I visited in the poor mountainous southwestern provinces of Yunnan, Guangxi and Guizhou, somewhere between 10 and 15 per cent of households were caught in this trap, unable to afford any chemical fertiliser whatsoever. In the worst-off villages, a majority of the families were in these straits.

In many parts of China, the credit associations' lending policies tightened considerably during the 1990s, making it increasingly hard even for families above the poverty line to obtain loans. In an increasing number of provinces, applicants now needed to find a guarantor who would accept part of the risk. Making the task more difficult, in many areas it was stipulated that unless the applicant had substantial assets the guarantor must be the village head. Since serving as guarantor involves personal risk, it is very difficult to obtain such backing. In Hainan Province, I supervised a survey in 1993–94 of 214 rural households spread across both prosperous and impoverished townships. The survey revealed that only 9.8 per cent of families had received any formal loan within the past year, and these households were largely among the wealthiest in their communities.

One reason for this tightening of credit availability is that much of the credit associations' lending volume was being diverted away from the villages to support the development of rural industry. This is even more the case with the other normal source of rural credit, the government-owned Agricultural Bank, which, despite its title, is largely a vehicle through which money gets drawn out of the countryside for non-agricultural investments. On average, the Agricultural Bank has been lending only some 16–17 per cent of its portfolio to village households (Nyberg and Rozelle 1999:27), and almost all of this has gone to the richest. All of these factors add up to a growing credit crisis within many rural communities. As the head of a relatively well-off village told me, 'The poorer villagers here can't even think of getting credit'.

If credit were available, it appears that many of the farmers would want to borrow, even at high interest rates. Poor farmers in Qinghai Province told me in December 2000 that, if need be, they would borrow at 20 per cent a year for desperately needed agricultural inputs, at a time when the commercial bank rate for agricultural purposes stood at 5.6 per cent.

In most of the Chinese countryside, when formal credit is unavailable farmers who are short of funds turn instead to relatives and close friends. But, in the poorer villages, relatives and friends are usually caught in similar financial straits. When desperate, farmers increasingly have had to turn to usurers, at rates of 50 per cent or more in the impoverished districts and reaching as high as 240 per cent (Guo and Xue 2000:412).

The central government's poverty-reduction programmes

The government is well aware of the predicament faced by the poor, and a number of special programmes have been established that are targeted specifically towards helping impoverished families. In particular, the State Council (the central government's cabinet) established a Leading Group for Poverty Reduction in 1986, and in the 14 years up to mid-2000 this organ had funnelled a total of 138 billion yuan into poverty-reduction efforts (State Council Leading Group 2000:32). In 1999 alone, 26 billion yuan (US$3 billion) of central government funds were budgeted to these ends (World Bank 2000:14). The great bulk of these funds has been directed to 592 designated 'national poverty counties'. A quandary, though, is that today more than half of the rural poor live in counties that have not been designated as official poverty counties (Riskin and Li 2001), and most of these poor live in non-impoverished villages. By government policy, they are cut off from most forms of poverty assistance.[3]

Within the nationally designated poverty counties, lists of impoverished households are usually drawn up based on village heads' appraisals. As a means to minimise the corrupt diversion of aid funds, noticeboards in each village listing these poor households are mandated in a good number of the counties. To a certain extent, this safeguard works. My interviewing turned up a number of very poor households that have received interest-free or low-interest loans under this programme. But the central government's efforts to constrain corrupt diversions of the funding have not always been successful. I came upon several instances where quite prosperous households had been provided with substantial aid-the-poor credit, and in all of these cases the households were closely connected to important local officials. In one, for instance, when I asked to interview a recipient, the man I was escorted to was the township Party secretary's elder brother, who lived in a well-furnished home.

Even officially, the central government has not always required that the aid-the-poor credit be directed towards a poor rural household. Starting in 1989 and lasting through the first half of the 1990s, priority was given instead to lending such funds to county factories, even to private firms, in the mistaken belief it would have a trickle-down effect by providing work for the poor. In 1992 and 1993, at the height of this programme, about half of all of the subsidised poverty-reduction loans were lent to industrial enterprises in the nationally designated poverty counties.[4]

But Beijing belatedly discovered that the programme had 'minimal or no poverty reduction impact' (UNDP and The World Bank, 2000:paras. 3.26–27). The poverty counties are poorly located for industrial development, and many of their enterprises, public and private alike, started losing money. Rather than promoting development, the enterprises became a drain on local government coffers. The central government eventually abandoned the trickle-down argument, and by 1996–97 the Leading Group for Poverty Reduction was specifying that loans be aimed instead directly at impoverished village households.

Nevertheless, rural governments sometimes continue to divert poverty funds to county industry. In 2000, the deputy head of the poorest county in eastern Qinghai Province (very close to where the Dalai Lama was born) advised me that the county was currently directing 30 per cent of the aid-the-poor credit provided by the central government into county-based industry, much of it private.

Microcredit projects

In the latter half of the 1990s, the Leading Group began to channel funds into microcredit programmes for the most impoverished farmers, and by 1998, microcredit schemes had been established in some 200 impoverished counties, with central government funding of about 800 million yuan (UNDP and The World Bank, 2000:para. 3.33). The projects have spread considerably since then. This programme drew inspiration from the experience of the Grameen Bank, and, in replication of that model, the loans need to be repaid in small increments at weekly or monthly intervals. Akin to the Grameen model, Chinese villagers also form small groups of four to seven member families, and each group is not eligible for further loans to any of its members if one of the members defaults. This mechanism takes the place of a requirement for collateral or a rich guarantor, in contrast to China's normal bank or credit association loans. And because no one in a group can receive a further loan if any other member defaults, the programme is supposed to provide an incentive for group members to help one another with advice about how to make good use of their microcredit.

In the best of circumstances – in particular, in some of the microcredit programmes separately sponsored in China by the World Bank and the UN Development Programme (UNDP) – the microcredit concept works reasonably well. This has particularly been so in projects where the microcredit has been made available exclusively to women. It has been shown in such programmes around the world that women have tended to be more assiduous and responsible in their use of microcredit loans, are less likely to turn such loans to consumption purposes, and tend to have a higher rate of on-schedule repayment.

The head of the UNDP's rural microcredit programmes in China, whom I interviewed in Beijing in 2000, noted that some of the most financially successful of the programmes have been those reserved for women only. He also noted that the all-women projects tend to have the most active and most participatory group meetings. Several Chinese specialists who have participated in microcredit projects related similar stories.

But, in most cases, the microcredit projects in rural China have run into problems that were inherent in the very nature of the programme. In Bangladesh's densely populated countryside, there are large numbers of landless poor women who engage in petty trade, and the Grameen Bank lends largely to this type of poor woman. By borrowing from the bank to increase their stock of goods, they are able to earn enough through daily sales to repay loans on a weekly basis. But the poor in China's programmes are farmers in marginal hill country, whose earnings are largely postponed until harvest time or until after an animal has been raised, fattened and sold. China's major current poverty-reduction initiative is being thwarted by the very fact that it was shaped to fit the circumstances of a very different type of poor in Bangladesh.

An illustration is provided by Dangchang county, the poorest county in Gansu Province, which is itself one of China's poorest provinces. Dangchang was provided with 3.6 million yuan to disburse as microcredit to the poor, but it distributed only 2 million, in part because its microcredit programme required repayments within a shorter period than the impoverished farmers needed to recoup any agricultural investment (*Jingji xinxi bao* [Economic Information Daily], 11 January 2000). A number of the other microcredit projects financed by the Leading Group operate just as rigidly.

The microcredit programmes are far better suited to villages where opportunities exist for farm families to diversify their sources of income by engaging in non-agricultural micro-entrepreneurial pursuits. I had an opportunity during 2000 to carry out interviewing for several days at a Grameen-style microcredit project with this type of clientele. The programme had been organised by a foreign government aid agency, and the initial intention was that the microcredit would be targeted towards the poorer households in the project area. But a second goal was to show that the programme was financially sustainable. A consequence was that, in each of the half-dozen villages that I visited, the poorest households had gradually been excluded from participating.

Some were excluded by their village's microcredit loan officer, who was seeking a high rate of repayment. Others were excluded by the fact that, with repayment a core issue, no other households were willing to be in the same credit small groups, as they would have to serve as the family's guarantors if it defaulted. Repeated interviewing suggested, however, that these people were not being excluded simply because of potential loan repayment questions. More than this, they are socially marginalised people in their villages. They often tend to have fewer, or no, relatives and do not belong to supportive social networks. Within their communities, their exclusion is a representation and confirmation of their marginalisation.

Some of the programmes sponsored by the World Bank make efforts to ensure that only the poor in each community are allowed to participate and that the village loan officer must be a member of a credit group and must be elected by the credit groups' participants. The foreign government aid agency whose project I studied went a step further, stipulating that in its project a majority of the loan officers needed to be women and that women were specifically to be targeted as loan recipients. (It was subsequently discovered in this project that the female loan officers were themselves more likely to take the initiative to arrange loans for women, and for a while a clear majority of all loans did indeed go to women.) But over time, as the foreign aid agency withdrew from active hands-on participation and handed over the project's administration to Chinese authorities, this all changed.

Rather than being chosen by the community, as was originally envisioned, the loan officers were increasingly simply selected from above. The Chinese programme directors now tended to turn to the most powerful people in the villages to serve as loan officers, perhaps in the belief this would help guarantee a higher repayment rate. After all, if the most powerful person in the village is the one who receives a small commission for every loan repayment, borrowers will feel under extra pressure to repay on time. The consequence is that the programme today reinforces the official political power structure within these villages. It has been reported that 40 per cent of the present loan officers are either village heads or village Communist Party secretaries (all men).[5] Their political power is strengthened by the fact that they now hold it in their discretion whether to provide and extend loans.

Conclusion

Even though these are serious problems, they are not the most significant. The most widespread and intractable problem faced by China's rural microcredit programmes is, quite simply, that the system does not appear well suited to people who cannot make repayments until the end of an agricultural season – and most of China's poor live in communities that rely almost entirely on agriculture. Other forms of credit also require less time and money to administer and can therefore be made available at lower interest rates.

In the best of the projects in China, though, one aspect of the Grameen Bank model has been shown to be worthwhile and ought to be preserved: the mechanism whereby the small groups of borrowers meet regularly and provide each other with suggestions. Such a programme offers a means for poor farmers with inadequate knowledge to learn from neighbours how to properly apply chemical fertiliser and how best to work their land.

Notes

1. Many of us hold reservations about chemical fertilisers because their misuse sometimes produces damaging side effects: to soil structures, rivers, and ecosystems in general. But the alternative in rural China spells hunger and stark poverty, as families that cannot afford chemical fertilisers struggle to raise crops in fields that lack nutrients. To be sure, such families add to the fields whatever organic fertilisers they can find; but, on the whole, those that use chemical fertiliser simultaneously add *more* organic fertiliser to their fields than can households which lack chemical fertiliser. The reason is simple: families with bigger crops also gain more silage as a by-product and are therefore better able to raise livestock, which produce manure that can go back into the fields. And fortunately this diligent use by Chinese farmers of organic fertilisers (including, of course, household faeces) to supplement applications of inorganic fertiliser helps to offset the potentially deleterious effects of chemical fertiliser misuse on soil structures.
   Misuse certainly exists, however. Discussions with agricultural specialists in China reveal that a great many farmers, and even

local agricultural extension officers, know little about how to apply fertilisers in ways that will retain a balanced soil. Higher yields mean more trace elements sucked out of the soil, and many farmers know nothing about the need to replace them. They know little about optimum levels of fertiliser use, and when they can afford to buy all of the fertilisers that they feel they need, they reportedly spread on too much. China would do well to use the mass media to provide advice on the use and abuse of chemical fertiliser. But, unless some miraculous genetic engineering of crops can provide a cure-all to the problem of depleted soils, chemical inputs remain all too necessary.

2. The ultimate reason why farmland cannot be confiscated by banks and why poor farmers also cannot sell off the land to meet debts is that villagers in China do not literally own their own land. Instead, the land remains in the ownership of the former collectives, and the fields have been distributed to the farmers free-of-charge for their use. In many villages, the plots of land get redistributed over time, again without payments, as some households expand in numbers and need more land and as other families shrink in size.
3. In the September, 2001, the central government released a document announcing that the distribution of poverty would be reinvestigated and a new list of 'poverty counties' would be drawn up. It indicated that up to 30 per cent of the poverty funds would be set aside in future years to assist impoverished villages that were not on the new 'poverty county' list, but, notably, this funding would all go to poor villages and the impoverished households in non-poor villages would still be excluded from the anti-poverty program (*South China Morning Post* [Hong Kong], 20 September 2001).
4. This is from paragraphs 8 and 10 of a second volume produced for internal distribution alongside the joint World Bank report, *China: Overcoming rural poverty* (2000).
5. On the power structure today in Chinese villages, see Unger (2000:ch. 10).

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Microfinance partnerships: Opportunities and challenges

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Introduction

Partnerships can produce substantial benefits and rewards and result in long-lasting alliances. However, they can also be challenging and difficult, time consuming and frustrating. If not approached properly they can end prematurely or, worse, in acrimony. This article is about Plan International's attempts to establish and maintain successful partnerships with local microfinance institutions (MFIs).

Plan is a humanitarian, child-focused development organisation without religious, political or government affiliation. Currently, it has programmes in 43 developing countries and a community development approach is used to increase opportunities for children to realise their full potential.

In 1994, sustainable microfinance was added to the organisation's programming strategy in an effort to promote economic security for families. Lacking the internal capacity to deliver these programmes itself, Plan decided to form partnerships with MFIs that share common goals and objectives. The partnership approach is essentially based on a set of principles promoting mutual respect and trust. This admirable intent is, however, not a simple thing to put into practice. Examples of extended relationships of shared trust and commitment are rare, especially between international non government organisations and local organisations.

Justification for the partnership approach

The first global Microcredit Summit in 1997, with representatives from 120 countries, affirmed that there were many viable institutions capable of delivering financial services to the poor worldwide. In an effort to build on this local capacity, Plan offices began establishing partnerships with local MFIs to implement credit and savings programmes.

Initially there was some resistance from staff who thought Plan should continue to deliver programmes directly. However, the majority of Plan's front-line staff do not have the expertise and capacity to deliver sustainable financial services. Furthermore, even if we chose to take the direct approach, the cost and time needed to develop sufficient internal capacity to operate sustainable programmes would be prohibitive. Microfinance strategies can only be self-supporting when they are both effective and efficient.

The case for working through partnerships is strong and based on the following:

- *Avoids duplication and builds on local capacity:* As the field of microfinance matures, more MFIs have established financial management systems and high-performance methodologies. Using existing capacity avoids the creation of a parallel provider.
- *More cost effective:* The initial investment of establishing an organisation has already been made, allowing more investment to go directly to services for clients.
- *Provides an exit strategy:* By investing in a sustainable local institution, the community will benefit after Plan withdraws from the area.
- *Leverages resources:* Established MFIs often contribute matching funds, in kind or in cash. Additionally, Plan's investment sometimes attracts investment from various international donors.
- *Opportunity for learning:* Both parties benefit from the other's experience and comparative advantage.

A search for equality

Plan named the approach 'shared vision partnerships'. These are relationships where parties work together as equals, using the process as the means of effecting programme and organisational goals. Such partnerships are founded on mutual trust, respect and transparency. Needless to say, this requires a high level of maturity and commitment on the part of both organisations.

The most successful microfinance partnerships for Plan have involved working with organisations that are committed to working with poor people (especially women), strive for sustainable programmes, are transparent in their operations and have systems for strong governance and accountability. When new partnerships are being established, it is essential that certain issues be addressed upfront, an example being agreement on the geographic areas both parties want to work in and common programme objectives. One of Plan's primary objectives is to introduce financial services into existing Plan programme areas, which are generally rural and hard-to-serve areas. If the Plan location is also part of the long-term strategy for the MFI, a feasibility study is conducted to confirm sufficient demand.

Plan's commitment to the communities it works with requires the organisation to reduce the risks that partnerships typically present. Plan has adopted a process of 'due diligence', which has turned out to be an important step in the development of partnerships for all parties. Due diligence is conducted by an independent expert and serves the dual purpose of assessing capacity-building needs for the organisation, while providing potential partners with the much-needed information that informs the eventual agreement. Plan often works with well-established MFIs but is also willing to invest in organisations that share a common vision and have a commitment to making their programmes sustainable. The due diligence process allows us to reduce the risk of investing in smaller MFIs.

The process of identifying potential partners, and getting to the point of agreeing to work together, requires an investment of both time and financial resources. Both organisations have to invest time in getting to know each other and deciding whether forming an alliance will be mutually beneficial. A financial investment in feasibility studies and due diligence analysis increases the likelihood of success. Experience has taught us that these are important and worthwhile investments. The more the attention paid to building the relationship and clarifying the roles of each, the higher the success rate of the programme.

Shared costs, roles and accountability

Plan supports MFIs in a variety of ways, including expansion into new areas, capacity building, and providing access to capital funds. Most of the costs of planning efforts, such as the feasibility studies and due diligence, are covered by Plan. Once an understanding is reached, the MFI invests in the development of a business plan detailing financial projections and other conditions to achieve a sustainable operation.

Actual implementation is the responsibility of the partner organisation. However, during the planning process and in the initial stages of the programme, a lot of coordination is required. Because working through a partnership is a new approach in areas where we have been involved for a long time, communities must be prepared. The process of introducing the programme is often a shared responsibility, with staff of both organisations present. Initially this was a concern for both partners, but we have found that transparency reduces the number of problems later in the programme and increases the trust between the staff of the two organisations.

The success of the programme is the concern of both parties; therefore, monitoring and evaluation are also shared tasks. Monitoring involves a monthly review of data and information on outreach, portfolio quality and progress towards sustainability. This process also includes a review of progress of implementation so that coordination can be strengthened, if needed. Both organisations are involved in monthly monitoring meetings and discussions. Evaluations look at overall progress towards objectives and at qualitative aspects. These take place at mid-term and at the end of the programme. Ideally a team is established, led by an external evaluator, with staff from both organisations being involved.

In addition to programme aspects, attention is paid to the partnership process during both monitoring and evaluation. It is very important to give attention to the partnership process throughout all stages and to make adjustments, where necessary, that strengthen the relationship and improve programming.

Is the partnership approach working?

Plan's partnership approach has had many positive results. An external evaluation concluded that 'there was evidence that the partnership approach has improved programming capacity in qualitative terms . . . [and] the overall direction being pursued is found to be valid'.

Certainly the most apparent aspect of improved capacity is expanded outreach, which lends itself to more quantitative measurement. Since 1994, 26 partnerships for the delivery of microfinance programmes serving 85,000 clients in 14 countries have been established. The performance of all the partnerships is tracked, and most enjoy a sound and healthy portfolio and are either well on the way to self-sufficiency or have already reached that goal.

Another important aspect is that, by working with local MFIs, the programmes reflect local environmental and cultural circumstances, as these also impact on programme effectiveness and client success. Many of the partnerships involve using traditional methodologies, such as Village Banking and Grameen, for wide-scale coverage. In some situations the partnership supports less commonly used approaches, such as the savings-led SafeSave in Bangladesh or the piloting of Financial Services Associations in Kenya.

One critical criterion of success that we are watching closely is that of sustainability. A key motivation for working with partners is to help to build an organisation that will continue to offer financial services to the community long after our organisation has left the area. The approach will truly be effective if the organisation continues to operate and to offer financial products that are useful to community members in their efforts to manage scarce resources and to improve household security.

Benefits of the approach

To learn more about the issues affecting our current partnerships, Plan commissioned an independent study of several of our microfinance partnerships to ascertain how well the approach works and how it can be improved.

The conclusion was that 'the partnership strategy brings key benefits to both Plan and its partners in achieving shared commitments to providing microfinance services to the poor'. These partnerships are part of a global movement in an industry dedicated to reaching poor families, especially women, with financial resources that enable them to improve their quality of life. Specific findings included:

- The partnerships reach thousands of poor individuals and families with sustainable financial services.
- The partnership approach helps to strengthen national capacity of sustainable microfinance in developing countries.
- Plan's MFI partners gain new financial and technical resources to expand coverage and develop new microfinance programmes.

- Plan gains strategic benefits, such as progress towards sustainable approaches development, improving programme quality, and attracting new sources of funding.

Plan and its partners must collaborate, since neither can run the programmes alone. We need partners for their specialised expertise and their national identities that position them for sustainability. The partners, in turn, need Plan for its financial resources, linkages to communities and access to other external resources. Plan country offices most often cited bringing microfinance services to communities and families as their goal for the partnership, since communities had expressed their need to access credit and savings. For MFI partners, the most common goal in partnering was to expand their geographic coverage to reach more of the poor.

A different way of working

Most of the partner organisations have experience working with donors who are willing to invest if their goals and objectives can be met. Plan's primary experience in the past has been the traditional contract for services, where money is paid to an organisation to provide specific services. Forming a true alliance based on mutual trust and respect, and approaching the design and delivery of services in a collaborative manner, is not easy for Plan or partner MFIs. It is even more difficult when one partner contributes financial resources and the other contributes technical expertise. Maintaining an appropriate balance of collaboration with these power dynamics poses challenges.

In order to succeed, *both organisations* need to consider all aspects of institutional history as well as organisational culture and systems. The following are some of the challenges we have encountered in working through partnerships. The behaviours and barriers were found among staff in both organisations:

- *Lack of cooperation contributed to delays and uncertainty:* A 'reticence' among administrative and field officers to actively participate in partnerships created delays. The two most common examples of activities that undermined the partnerships included meetings planned but not held and delays in getting formal agreements signed. The causes ranged from simple lack of understanding of what was required, to open resistance. It was clear that staff working in offices that had established an environment conducive to sustainable development were notably more comfortable making the shift to the partnership approach.
- *Commitment to partnership not consistent across all levels:* Delays in signing off on partnership agreements and financial transactions reduced effectiveness. In most cases, the time involved between initial discussions and a signed contract is well over a year. In other cases, even when agreements had been signed and reports properly submitted, there were delays in implementation. Reasons included turnover of staff, lack of prior information and involvement, and lack of understanding of the value of partnership. In general, agreements were eventually signed and funds released, but delays were costly, started the partnership off on a bad footing and even sometimes jeopardised the success of the programme. The delays worked against one important benefit of partnership: quicker start-up times for programme implementation.
- *Unclear roles can put stress on the partnership:* A lack of clarity regarding roles and responsibilities caused tensions and sometimes problems. In some situations, the approach to monitoring was perceived as intrusive and overly critical. In one case, the partner felt that Plan was acting like a 'watchdog'. Further exploration of this revealed that past experiences with contracting relationships had influenced the perspective of staff. To combat the 'watchdog' view, Plan worked to increase the level of trust and understanding, which resulted in stronger and more effective partnerships. Once it was understood that both parties are accountable to the communities and clients for the success of the programme, the monthly monitoring discussions became more informative and constructive.
- *Clear agreements are important and communication is essential:* Agreements need to include sufficient information to establish a firm commitment (which can extend over a period of years), clear objectives, indicators for achieving the objectives, delineation of roles, and how accountability will be achieved. Attention needs to be paid to communication, both within each organisation as well as between them. Communication needs to be both formal and informal. In cases where the partnerships worked best, formal communication channels were created at the local level in addition to the national level. This permitted information to be shared and issues to be resolved more efficiently.

Challenges for the future

Experience indicates that a number of factors are important to successful microfinance partnerships:

- active commitment from top management to front-line staff;
- leadership that encourages, supports and rewards staff performance consistent with effective partnership relationships;
- knowledgeable and interpersonally skilled staff who can build team spirit and bridges within your organisation and with partners;

- willingness to learn and to change practices when necessary for the success of the partnership;
- open discussion of partnership challenges, allowing staff to resolve and even predict difficulties;
- collaboration in planning, problem solving, monitoring and evaluation;
- agreements and relationships that transcend individuals mean that staffing changes won't interrupt or jeopardise operations; and
- long-term commitment to partnership acknowledges that it takes three to five years to build a sustainable programme and anticipates benefits that will continue long after the formal agreement is concluded.

All those involved in development face the challenge of how to be more efficient and effective in our work. In terms of microfinance, it will be important to understand the changing needs of communities for financial services and how to design effective financial products and methodologies for delivering services to meet community needs. Plan has found that partnerships, while not without their challenges, provide the best approach to efficient and effective programming and service delivery.

If we are to sustain our commitment to communities, we must continue to invest in local organisations to ensure that they have the capacity to continue providing services to communities for years to come. Plan has set goals to substantially increase the number of microfinance partnerships established over the next five years. The organisation will continue to provide guidance and support for staff and partners throughout the partnership process and will work collaboratively to formalise tools and other materials.

We know that being more aware of how one's organisation operates is important and we need to regularly review our practices and procedures. Systems and procedures will be adjusted as needed and investments made in building capacity of our own staff. Regular forums to talk with partner organisations and to involve them in the learning process are also part of the agenda.

In the future, MFIs will be facing many challenges. Local environments are changing, as are the needs of clients. To be successful, MFIs will need to anticipate and adapt to these changes and needs in a timely, efficient and effective manner. Organisations like Plan and local MFIs will need to align more closely to expand outreach to new areas, build sustainable institutions and improve the delivery of services to address the needs of poor clients.

Acknowledgements

Most of the information in this article comes from the direct experience of several Plan country offices and local microfinance organisations. It is their persistence and patience in forming relationships, and their cooperation in reviewing and assessing the experiences, that have resulted in learning.

The concept of shared vision partnerships was adopted from *Models of inter-organizational collaboration in development* (1994) by Mark Leach for the Institute for Development Research, Massachusetts. The model now used by Plan has evolved over the past seven years from experiences in the field.

Credit unions and microfinance innovation

Grahame Mehrtens, Credit Union Foundation Australia

Introduction

Savings mobilisation based microfinance activity is neither a new nor a recent phenomenon. In the late 1840s, Frederick Wilhelm Raiffeisen, mayor of a small rural village in Germany, embraced the emerging social force of the time that was exemplified by cooperative principles flowing through the retail trade of Europe. Cooperation represented an opportunity for people to escape exploitation and regain dignity and self-respect through collective action and mutual self-help. Raiffeisen formed a mutual cooperative through which local farmers could pool their savings and lend to one another at reasonable rates of interest. From this enlightened beginning has grown a global credit union movement that today serves in excess of 108 million members in more than 90 countries.

In a world where 5 billion people 'have less' and 1 billion people 'have more', this movement continues to follow its pioneer's lead. It still provides mutual self-help development opportunities with dignity, for people traditionally denied access to savings and loan products from the formal banking sector, simply because they are poor or deemed to be otherwise 'unbankable'. Grameen and Grameen replication projects and activities abound throughout the developing world and much is printed and heard about this methodology. However, the credit union system has been quietly refining its own approach to sustainable community development and examples are now proliferating.

Partnerships are fundamental to the credit union model and in the Asia–Pacific region, the geographic sphere of Credit Union Foundation Australia (CUFA) operations, sustainable credit union microfinance growth is occurring in Fiji, Vanuatu, Solomon Islands, Samoa, Bougainville, Cambodia, the Philippines, Indonesia, and Papua New Guinea.

A perception of some development sector observers is that credit unions have become banking vehicles for the middle class. Be that as it may, since 1990 the Association of Asian Confederation of Credit Unions (ACCU), a regional peak body for 14 national credit union movements throughout Asia, has been implementing a 'credit with education' programme among its members. ACCU has initiated a low-cost, innovative methodology for increasing outreach to the 'have less' in its region.

Innovation

ACCU has established a network of partnerships with its various national members, to extend savings and loan services to the 'E-poor' (entrepreneurial poor): people who have the skills to run an income-generating activity but lack access to capital with which to ensure its economic viability.

This innovative concept is based on recruiting existing credit unions to become actively involved in outreach to the poor in their communities. It requires an on-going commitment to embrace what is in some cases quite new, challenging or radical behaviour, particularly if a credit union has grown away from its traditional base. The credit union must allocate human and financial resources to ensure eventual sustainability of this development process. It is encouraged to establish an internal structure, with at least one staff member dedicated to the new activity. It must also develop discrete policies and procedures to underpin the fieldwork that results in new E-poor members. The methodology is in effect a separate project, additional to the credit union's on-going regular member relationships.

With a structure established, policies and procedures in place and a committee formed to manage the overall activity, an amount of previously mobilised members savings can then be determined and isolated as the initial capital for loan purposes. Fundamental to this approach is the 'firewall' established to isolate reporting and accountability of this new outreach from the normal operations of the credit union. Discrete savings and loans products are made available to E-poor members, and deposit and repayment records are compiled quite separately from the regular books.

Training

The training of staff, volunteers and potential E-poor members is a vital aspect of the implementation process for this methodology. An understanding of the rights and responsibilities inherent in membership of a financial cooperative is crucial in building a foundation for eventual sustainability of the enterprise. In most cases, new E-poor members have had minimal exposure to the formal banking sector, with many having no experience at all, and the development of trust that underpins saving with a second party has to be nurtured from a very low base.

Similarly, the notion of regular repayment of a loan that has been made from the savings of other people, perhaps family, friends or neighbours, is introduced at an early stage. A slogan that has gained wide currency in the credit union movement is:

'Save regularly

Borrow wisely

Repay on time'

Pre-membership training for prospective new members typically covers:

- Day 1: History of the cooperative (credit union)
- Day 2: Definition of microfinance
- Day 3: Roles and responsibilities of officers and members
- Day 4: Savings and loans
- Day 5: Graduation day
- Days 6 & 7: Follow-up visits to a member's home after granting of first loan

Microfinance Seed Fund Initiative

During the year 2000, ACCU took the opportunity to extend its E-poor outreach to more people through access to the Australian Agency for International Development (AusAID) Microfinance Seed Fund Initiative. In partnership with the Philippines Federation of Credit Cooperatives (PFCCO), the Credit Union Coordination of North Sumatra (BK3D-Sumut) and CUFA, ACCU developed a project that focused on two contrasting implementation environments: the slum suburbs of Metro Manila and rural villages in North Sumatra.

The major objective was to improve access to innovative microfinance products and services for low-income credit union members in order to encourage and enhance the sustainability of their income-generating microenterprises. The activity is a poverty reduction strategy designed also to strengthen the institutional capacity of credit unions to respond to the increasing global focus on microfinance.

Twenty credit unions in each location were identified for potential recruitment to the project, with each expected to extend outreach to a minimum 100 E-poor new members in the first 12 months. A minimum savings target of A$40 per new member was set, with a total of A$80,000 new savings to be generated over three years in each location. Loans totalling A$120,000 to 1,500 borrowers were anticipated for the first year, rising to A$360,000 to 3,000 borrowers in the second year. Achievements in the first year of activity are recorded in Table 1.

Implementation outcomes

Representatives of CUFA and ACCU conducted a monitoring visit in June 2001 to the Manila and North Sumatra locations. Significant insight was gained regarding community level acceptance of the concept and the relative success of implementation by:

- consultation with participating credit union board members, volunteers and staff regarding the process of policy development and agreement to commit resources;
- discussion with peak body project staff to clarify specific implementation issues and difficulties;
- observation of scheduled weekly group meetings of E-poor members (for example, a number of self-help groups, normally comprising five members each, in a combined meeting); and
- interviews with selected individual beneficiaries.

A very positive aspect of regular meetings was the ready willingness of E-poor members to report individually about their activities during the previous week. This leads to a sharing of successes, difficulties and/or problems, a process that often results in a group solution being found to a problem and in a strengthening of community spirit.

Individual case studies: The Philippines

Rag making (Mrs Remy Macabata – Group Leader)

The five women in this self-help group (SHG) are neighbours and all are engaged in rag making. It was an existing microenterprise and the women learned of the microfinance (MF) project from other people previously recruited by SIKAP[1] Development (Multi-Purpose) Cooperative.

The group members were all keen to join the scheme because it offered access to a savings vehicle, such access previously being

Table 1 Results after 12 months of credit union outreach in Metro Manila and rural Sumatra

Indicators	*Achievement*		*Target*	*% Achievement*	
	Philippines	Indonesia		Philippines	Indonesia
Number of CUs recruited	14	20	20	70	100
Total number of new members	1,517	2,201	2,000	76	110
Average number of new members per CU	108	110	100	108	110
Total savings accumulated	$83,562	$86,377	$80,000	104	108
Average amount of accumulated savings per CU	$5,969	$4,319	$4,000	149	108
Average amount of accumulated savings per member	$55	$39	$40	138	98
Total amount of loans released	$269,631	$152,123	$120,000	225	127
Average loan amount per member	$178	$69	$80	223	86

Note: all amounts in A$ approximate conversions.

unavailable to any of them. Although individually they had been able to save 20 Pesos a day (A$0.80), this amount is too small for a bank to be interested in processing, and saving at home leads to temptation to spend. Savings are collected daily from group members and deposited daily in SIKAP Cooperative.

Before they became MF members, rag-making activity by all the women had been sporadic as they lacked capacity to borrow the capital required to work consistently. The loan from the MF project is the first any of the women had ever received and they are now producing continuously for sale in local street markets. There is on-going demand for this product in the broader Metro Manila environment and the group is negotiating to supply a wholesaler for wider distribution. However, the wholesaler requires a receipt for business purposes and, because the SHG is an informal structure, this creates a difficulty that the group is trying to resolve by seeking authority to access the SIKAP Cooperative receipts process as required.

Prior to joining the SHG, Remy Macabata (Group Leader) was aware of SIKAP Cooperative but was unable to meet the initial capital deposit requirement of P500 (A$20) for regular membership. The ambition now of each of the women is to become a regular member of the cooperative.

Vegetable selling (Mrs Gloria Tobillo)

Gloria Tobillo and her two daughters had an existing business, selling raw and cooked vegetables at a roadside stall, and she was recruited by her neighbour to become a member of a SHG. Every morning at six o'clock Gloria travels five kilometres by tricycle cab to purchase the daily stock of raw vegetables, which are sold first. Towards the end of the afternoon, any surplus stock is cooked for sale.

The first loan Gloria received from the MF scheme enabled her to revive her business, which had become dormant from lack of capital, and her plan is to use the increased loan available from the second cycle to purchase a refrigerator for storing cooked food. She has been advised by project staff to increase her savings and use the accumulated cash to make the purchase. Gloria is also seeking to become a regular member of the cooperative.

Bottled water selling (Mrs Carolina Crueta – Association President)

Carolina Crueta's daughter was one of the first children to take up the Youth Bee savings product, an ACCU devised savings product designed to attract children and young people. The ease of access and the availability of a savings mechanism attracted the family to the MF scheme.

One of the major utility problems in this area of Manila is that ground water is very deep and expensive to access. Carolina owns land on which there is a deep well with an electric pump and she sells one-gallon containers of non-potable water for P1 (A4 cents). The local authority is slowly improving piped water supply, which will eventually replace this business. When that time comes, Carolina intends to enlarge her baby clothes sewing business.

Wholesale rag sewing (Mrs Lourdis Cabarubias)

This is an existing home based wholesale business using two sewing machines. Lourdis Cabarubias balances her time between managing a household that includes four preschool-aged children and running her business. Capital equipment expenditure is not generally within the MF loan policy of the cooperative and the loan provided to Lourdis was for the bulk purchase of material. A practical difficulty that needs to be overcome is that the initial maximum loan of P1,500 (A$60) is insufficient for Lourdis to maximise the benefits gained from bulk buying at the lowest possible rate.

The wholesale rag sewing business does not necessarily generate daily income, as the process involves purchasing material, cutting and shaping, and then sewing enough stock to satisfy the demands of street retailers. Finished rags are sold to retail vendors at P100 (A$4) per bundle, creating retail value of P300–400 (A$12–16). Because production of the finished articles does not result in daily income, the MF scheme has adopted a flexible approach to the standard requirement for daily loan repayments and, in this case, repayments are weekly.

Fish-ball vending (Mrs Marjorie Buenobra)

Marjorie Buenobra's family has been involved in an itinerant fish-ball vending business since 1993. The street vending cart is leased at a daily rate of P150 (A$6) from a fish products wholesaler, who also supplies fish and squid balls in bulk to vendors. Squid balls retail for P2 (A8 cents) each and fish balls for 50 centavos each (A2 cents), and daily sales total approximately P300 (A$12). From this income, the family makes a daily loan repayment of P70 (A$2.80), with the balance available for other expenses or saving. Santo Tomas De Villanueva, the parish credit cooperative involved in this district, is investigating the feasibility of manufacturing vending carts in bulk and leasing them to vendors at a lower rate than they are paying currently.

Junk shop (Mrs Delfin Bassig)

Delfin Bassig's business collects empty bottles for resale by the sackful to bottling plants, which pay on a per bottle basis. The business also collects and sells scrap metal and newspapers. The scrap component of this microenterprise is supplemented by a food stall in the narrow alleyway in front of the shanty in which the family lives. A demonstration of the globalisation of information technology was seen in this home as, surrounded by open drains and rotting garbage, a family member was keeping business records on a home computer.

North Sumatra experience

Credit Union Satalop, Siborongborong, joined the MF scheme from a background of group lending activities involving regular members, albeit with larger groups (20–25 people) formed on occupational lines (poultry farmers, pig farmers, fruitgrowers, crop farmers). The Catholic Church was the instigator of this approach, using group solidarity as the basis of group interaction. When it withdrew its support, the credit union took over.

The scheme is open to anyone able to meet the financial and pre-membership training requirements for regular membership. The financial requirements comprise: education costs (Rp30,000/A$6), compulsory savings (Rp15,000/A$3), initial savings (Rp10,000/A$2), and the membership fee (Rp30,000/A$6). The training, over five consecutive weeks, covers: the benefits of mutual help, the credit union difference, family budgeting, credit union by-laws and policies, and loan process/procedures.

Saving starts during the training period, so that by the time training is finished, the compulsory savings amount has been accumulated. At the completion of training, the initial savings and the membership fee are paid. In addition, intending members must be sponsored by five regular members and be under the age of 45 years. There is no minimum age for either membership or taking of loans, but loan applicants must be married.

The credit union also monitors and penalises non-savers by adjusting individual payment of dividends according to savings patterns. For example, if a member fails to save for a period between three and six months in any year, he or she receives only 50 per cent of the annual dividend. If they fail to save for seven months, no dividend at all is paid.

Interviews were conducted with two SHGs, comprising a total of 11 members (all male) and formed in January 2001, in the area adjacent to the town of Siborongborong. Coffee, chillies, tomatoes and other vegetables are the main crops grown. All produce is sold on local markets and, to ensure a consistent price, especially for coffee, output is generally limited to an average of 110 kg/farmer/week. The main benefit gained from joining the MF scheme is now having a secure place to save regularly. Prior to the scheme starting up, any surplus cash tended to be spent. Group members rated the opportunity for regular education sessions very highly, as well as recognising the importance of regular saving to building a better future for their families.

The credit union loan process is a major advantage for members because of its flexibility and reasonable rate of interest. Members are aware that improvement in their living standards depends not just on money, but also on their own willingness to change. Those people with previous bank borrowing experience reported the main difference as interest charged on reducing balance rather than the bank's flat rate, with principal repayment at the end of the term. Moneylender experience was quoted, using an example loan of Rp1.5m (A$300) monthly repayments of Rp65,000 (A$13), with no documentation and no specific loan term – effectively an open-ended repayment regime, dependent on the moneylender saying 'enough'.

Conclusion

The brief examples above highlight the growing influence of credit union innovation in the microfinance field and the increasing benefits that are flowing to the E-poor in selected member credit union movements of Asia. Similar results, albeit on a smaller scale, are now being recorded also within the South Pacific region. Raiffeisen would feel very much at home were he able to observe the fruits of his labour.

Note

1. *SIKAP,* a Tagalog word meaning 'to strive, or striving, to reach a goal'.

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Potential roles for donors in the development and promotion of microinsurance

Craig Churchill, Social Finance Programme, International Labour Organisation

Introduction

Throughout the development community, and within the microfinance industry in particular, there has been a recent surge of interest in microinsurance. Numerous conferences, studies and reports on the topic have surfaced over the past couple of years. This surge can be attributed to the following factors:

- *Developmental:* Recognition that the vulnerability of low income households is not eliminated by access to microcredit alone, and the belief that microinsurance may help low income households to manage risks.
- *Commercial:* Microfinance institutions (MFIs) consider insurance as a means to improve portfolio quality, since a significant cause of loan loss can be attributed to the death or illness of a borrower or a borrower's family member. MFIs are interested in developing new products, serving new markets, enhancing customer loyalty and improving competitiveness. There is an expectation that the premiums or agent's' commissions from microinsurance could be a new source of capital for MFIs. A significant barrier to providing insurance to low income persons is the cost of distribution, so the distribution channels of MFIs create new opportunities for insurers to minimise transaction costs.

Many of the microfinance organisations becoming involved in microinsurance lack an appreciation of the challenges of offering insurance. This article suggests ways in which donors and other interested parties can judiciously advance the development of microinsurance by seeking answers in six content areas: delivering risk-managing financial services; understanding the demand for microinsurance; promoting outsourcing; reducing transaction costs; encouraging innovations (new products and new delivery agents); and shaping the enabling environment (regulation, reinsurance and data collection).

Defining microinsurance

'Insurance' is a commonly misused term. Often people say 'insurance' when they are referring to savings or credit products that fulfil a risk-managing function. For insurance to be insurance, it needs to involve a risk-pooling mechanism, which combines the resources of the many to compensate for the losses of the few. In effect, policy holders pay premiums for the average loss suffered by the group, rather than the actual cost incurred when a risk event occurs. Risk pooling benefits the *few* who suffered the loss, while the *many* basically receive peace of mind in exchange for their premium payments. The value of an insurance benefit is stipulated in the insurance contract; it is not related to the value of the premium payments that have been made. If the pay-out amount is directly related to the value paid in, then the client is receiving a savings or investment service, not insurance (Brown and Churchill 1999).

The 'micro' aspect refers to the size of the policies and, implicitly, to the target market of low income persons or households.

But not all microinsurance is alike. Some insurance products, like basic credit life insurance, are fairly straightforward, while others, like annuities and health insurance, are extremely complicated. Discussion of microinsurance must avoid making generalisations that group together the host of insurance products.

Delivering risk-managing financial services

If the developmental motivation for offering insurance is to reduce the vulnerability of the poor by providing a specific financial service that allows them to better manage risks, then it is implied that insurance is an appropriate financial service to achieve this objective. Savings and emergency loans can also be effective tools for managing risks.

Whether insurance is more effective than savings or credit as a risk-managing tool depends on the significance of the loss, the potential for risk spreading, and the likelihood of the risk occurring. Where the potential loss is relatively large and the likelihood is fairly uncertain[1], insurance may be an appropriate intervention. If the potential loss is relatively small or likely, then savings or credit would probably be more appropriate (Brown and Churchill 1999). Since they fulfil different purposes, insurance, savings and loans, should be viewed as complementary: insurance for the few risks that are insurable (for example, those that are easily observable and idiosyncratic); savings for persons with a little bit of extra money and the foresight to plan ahead; and emergency loans to reduce the need to sell off assets and to allow people to borrow against future earnings.

Liquid savings and emergency loans are considerably more flexible than insurance because they can ameliorate the effects of numerous economic stresses in the life of poor households. A life insurance policy will not help someone if their house burns down or if their business is robbed. It is recommended, therefore, that insurance not be viewed in isolation. To maximise the risk-managing value to low income households, donors who receive requests for microinsurance projects should check for the availability of other microfinance products like emergency loans and liquid savings accounts.

Understanding the demand for microinsurance

There is a considerable gap between theoretical and actual demand for insurance. Although there is no denying that low income households are extremely vulnerable, early research on the demand for insurance suggests that the poor may not consider insurance as an appropriate means of managing risks for several reasons:

- *Education:* Demand for microinsurance may be suppressed because many low income people are not familiar with the risk-pooling concept, or they have an incorrect understanding about insurance. Research among micro-entrepreneurs in Lusaka, Zambia, for example, revealed that 38 per cent of the sample had no understanding of insurance and an additional 30 per cent had only a basic familiarity. The level of understanding was strongly correlated to levels of literacy and formal education (Manje 2001).
- *Negative perceptions:* Insurance can lend itself to fraudulent schemes, which create negative publicity for legitimate insurance products. Because insurance is commonly sold on a commission basis, it can create incentives for inappropriate selling. Even if there have not been any local scams or instances of over-selling, consumers tend to have unfavourable opinions of insurance salespersons because they appear to be profiting from other people's miseries. If the local insurance industry has a reputation for inappropriate selling, rejecting claims based on fine-print technicalities or paying claims extremely late, insurers will have difficulty selling policies to an already tepid and timid market.
- *Regional variations:* Early efforts to assess the demand for insurance have identified significant regional differences as well as occasional cultural biases against insurance. Market research by Group de Recherche et d'Echanges Technologiques (GRET) in Cambodia, for example, identified a strong demand for health and life insurance, but much less interest in property insurance for livestock because, in that context, caring for animals was an individual matter (cited in Brown and Churchill 2000). In Zambia, some persons considered life insurance taboo because it indicated that they were preparing for their death. At the other end of the life spectrum, Zambian respondents did not consider childbirth an economic stress because the families had considerable preparation time (Manje 2001). In contrast, participatory market research in Nepal identified significant demand for both livestock insurance and coverage for maternity related expenses (Simkhada et al. 2000).
- *Poverty level:* There are two lines of thought on the relevance of insurance for the poor. On the one hand, the poorest are the most vulnerable segment of the population, and the most risk averse. As a result, it is inferred that the demand for insurance to reduce their vulnerability would be greatest among the lowest income households. This expectation is borne out in some environments with certain types of coverage. For example, households in South African townships indicated that their top expense priority each month was to pay the premium on their funeral insurance policy (Roth 1999). The counter argument is that insurance is a luxury which only people with excess income can afford. Many comments in Manje's 2001 Zambian study were along these lines. If a low income household is faced with the choice between putting food on the table and paying a premium for protection against an unknown future risk they are likely to spend their money on food. If low income persons pay premiums but do not need to make a claim (and they hope they will not), they may well feel that they have wasted their meagre resources. Early experience with short-term, voluntary health insurance suggests that poor people who do not make claims are much more likely not to renew their subscription than policyholders who make claims (McCord 2001).

Further market research and careful pilot testing is needed to understand demand before donors and support agencies actively promote the wide-scale replication of microinsurance products.[2] If latent demand exists, the market research information (and donor support) could be used to help microinsurers design appropriate products, marketing strategies and public awareness campaigns.

Promoting outsourcing

The provision of most types of insurance is very complicated, requiring significant expertise in actuarial analysis, data management, and crystal-clear policies and flawless systems to prevent fraud, moral hazard, adverse selection and (with health insurance) over-usage. If insurance is provided by an organisation that also issues loans, it is essential that extreme care be taken to separate credit and insurance risks. One way to extend insurance to low income households without threatening the MFI's capacity or skills is to outsource some or all of the technical requirements to an insurance company.

This outsourcing model can be structured to allow both parties to do what they do best. The MFI can focus on its core business of savings and loans. The MFI brings to the table its existing relationship and familiarity with the low income target market. Its loans officers, in effect, could become the insurance company's sales agents. This arrangement benefits the MFI, since it gets a new income source and has a new product to offer its customers (which may improve the performance of other products), without causing either a significant drain on the MFI's financial and management resources or, most importantly, causing an insurance risk. Furthermore, a relationship with an insurer enables the MFI to have access to the latest developments in insurance technology and information systems.

An insurance company may be interested in exploring the outsourcing option because it provides access to a previously untapped market, which it could not have reached on its own, through an existing infrastructure that clients already trust. By partnering with larger MFIs, the insurance provider is given the opportunity to quickly reach many customers, which would create economies of scale and increase the likelihood that actual claims would track closer to expectations (Brown et al. 2001).

The outsourcing relationship can be structured in a variety of ways. At one extreme, the insurance company could do the actuarial analysis, design and price the product, manage the administrative functions, and hold the insurance risk. At the other extreme, the MFI could purchase technical and consulting services from insurance experts on an as-needed basis.

The potential promise of this model suggests that donors can support initiatives that promote partnerships between MFIs and commercial or cooperative insurers. Potential projects to increase the involvement with these partners could include: documenting existing outsourcing relationships; developing a business plan to market the microinsurance opportunity to potential insurance partners; drafting guidelines for MFIs in how to select an insurance partner or consultant; facilitating discussions between MFIs and insurers through conferences and round-table discussions; creating incentives for insurers to collaborate with MFIs; and encouraging apprenticeship and consultancy relationships between MFIs and insurers.

Reducing transaction costs

As with savings and credit, one of the major challenges of providing insurance to low income households is managing the high transaction costs associated with issuing many small policies. Although most MFIs are striving to improve the efficiencies of their lending operations, the primary means of covering the transaction costs of providing sustainable microcredit is by charging high interest rates.

Microinsurance providers do not have the luxury of charging high rates, since the demand for insurance is softer or less elastic than the demand for credit – for example, microinsurers do not have the high-priced competition from informal insurance sources that microcredit faces from informal moneylenders. This contributes a fifth factor to the demand issues identified above: policy holders may be deterred from purchasing insurance, regardless of its benefits, if coverage is too expensive or inconvenient for poor households.

For insurance providers, transaction costs occur in connection with five activities: sales, collecting premiums, preventing premium lapses, verifying claims and making payouts. For each of these activities, additional R&D is required to improve efficiencies in delivering insurance without jeopardising customer value.

The primary means of reducing transaction costs thus far has been to layer insurance delivery on top of another financial service, usually credit. This integration allows the first three categories of transaction costs to be shared, so the only substantial additional effort involves verifying claims. Efficiencies are further enhanced by making the insurance product mandatory, but at what cost to customer value? Are clients paying for something that they do not want? Mandatory credit life insurance can be viewed as expensive and predatory. Moreover, does the mandatory nature of the product reduce the insurer's incentives to design the product to meet customer demand?

The layering of insurance on to credit also means limiting coverage only to those people who have a loan. Since people may want coverage without having to service a loan, layering insurance onto a savings product seems to be a more effective way of providing protection. Indeed, this is what credit unions have been doing for some time. The savings–insurance twinning lowers transaction costs for both insurer and policy holder by having the premium payments made by the savings account, either as an account deduction or in lieu of interest, both of which have been tested by the Self Employed Women's Association (SEWA) in India.

It is recommended that donors extend support to organisations that are interested in experimenting with a savings–insurance link, since it is likely to generate greater developmental benefits than a credit–insurance link. Since many MFIs only provide credit, in most cases it is recommended that they be advised to develop savings services before venturing into insurance. In addition, there is certainly scope to support experiments with new technologies and other means of lowering transaction costs for both parties.

Encouraging innovations

As a new service that has both commercial and developmental objectives, significant support should be given to innovative efforts that will expand the scope and deepen the outreach of insurance services in a sustainable manner. Besides efforts to lower transaction costs, insurance innovations fall into two major categories:

- *New delivery agents:* Microfinance institutions are just one way of delivering insurance products to low income households. While MFIs have the potentia l to be excellent delivery channels, they are not the only type of organisation that already manages financial transactions with large volumes of low income persons. For example, in Colombia, Royal and Sun Alliance offers life insurance in partnership with a local utility company. Marketing and enrolment are done through the utility company's monthly billing system; the benefit is two years worth of utility expenses. Similarly, another Colombian insurer offers life insurance through affiliated grocery stores, and the benefit is a year's worth of groceries. Besides highlighting alternative delivery agents, these examples also demonstrate that in-kind benefits are one way of deepening outreach, since the insurance company can negotiate a wholesale price on the benefit package (Brown and Churchill 2000).

- *New insurance products:* The jury is still out regarding what types of insurance products would appeal to low income persons. Thus far, the two insurable economic stresses that are cited most frequently are illness and death, but there still may be pockets of demand for business risk coverage as well as theft, fire and other property risks. Insurance for agricultural risks could have a significant developmental impact and be in high demand, but significant innovations would be required to overcome the negative historical experience with such coverage. Based on early market research efforts, the one product that would probably be in demand is a medium-term (three to five years) life insurance policy that would accumulate in value while providing protection against death risks. This product would overcome many of the unfavourable perspectives on insurance since policy holders would have something to show for their premium payments besides peace of mind.

Shaping the enabling environment

Lastly, donors and support agencies can play a valuable role in shaping the enabling environment in which microinsurance operates. There are three elements worth considering:

- *Regulations:* While the regulatory environment varies by country, most MFIs are not able to legally offer insurance services. This restriction strengthens the case for the partner–agent model described above. Even with that model, however, in many countries regulations unintentionally restrict regulated insurers from entering the low income market. For example, high minimum capital requirements for insurers would discourage them from pursuing small policies for poor households; or the documentation requirements, intended for consumer protection purposes, may be a deterrent for illiterate customers. These circumstances push institutions to develop small insurance policies for low income clients outside of the regulatory environment. Donors should give careful attention to appropriate regulatory conditions to support a deepening of insurance outreach without jeopardising the health of insurers or reducing consumer protection.
- *Reinsurance:* A critical aspect of insurance provision is reinsurance, or the ability to shift part or all of the risk from one insurer to another. This arrangement broadens the risk pool and enables insurers to withstand catastrophic losses caused by co-variant shocks, such as epidemics or natural disasters, that can affect many policy holders at once. Reinsurance is also a means of providing technical assistance; for example, the reinsurer can assist the primary insurer with pricing, designing safeguards against adverse selection, and developing underwriting standards. Any effort to develop microinsurance should consider channelling support through a reinsurance mechanism.
- *Data collection:* A par ticular challenge in offering some types of microinsurance is the dearth of appropriate data from which insurers can conduct actuarial analysis and make pricing decisions. Donors could consider supporting the collection and analysis of data, such as a disaggregation of mortality rates and causes, which would enable insurers to make more informed decisions regarding risks, client screening and pricing regimes.

Conclusion

Donors receiving requests to support microinsurance projects have a responsibility to guide and temper the budding enthusiasm associated with insurance for the poor. At this stage, we do not know enough about the demand for these services, the most effective design of microinsurance products, or the appropriate delivery channels to proceed without considerable caution. The top priorities must be to support innovative ideas that are rooted in confirmed insurance fundamentals and to document lessons as they emerge. The use of subsidies to underwrite experiments in these priority areas is justified, especially where they will contribute to donor concerns to avoid creating long-term dependency on donor funding.

Notes

1. Uncertainty has three different elements: if, when and how often? For example, although it is certain that we will all die at some point, the uncertainty arises from not knowing when.
2. An exception to this statement might be credit life insurance, which many MFIs implicitly offer, although they may not call it insurance. Because 'coverage' for the outstanding balance of the loan in the event of the borrower's death is already commonplace (sometimes including a small pay-out to the beneficiaries of the deceased), there is a role for training on how to design, price and deliver this product in a way that will increase customer value. This is the subject of a forthcoming training manual by the ILO's Social Finance Programme, tentatively entitled 'Making Microinsurance Work for MFIs'.

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Microfinance best practice: ten parameters of success for development NGOs

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Introduction

Experience has shown that development NGOs typically do not succeed in transforming themselves into financially sustainable providers of financial intermediation services. The reasons for this failure are complex (see Dichter 1999). Nonetheless, the role that NGOs play as microfinance providers is important and the contribution they could make to poverty reduction would be greatly enhanced if they adhered to some simple but essential parameters of success.

Benchmarking and microfinance best practice

The numbers of microfinance institutions (MFIs) and their clients has grown exponentially since the 1980s. This growth heralds today's conventional wisdom that socially responsible development cannot ignore microfinance and microenterprise development (MED).

The global outreach activity of dedicated MFIs is presented in Table 1. These data, from a range of sources, do not include the outreach of many thousands of development NGOs with less than 1,000 microfinance or MED clients. If that data could be added, it would probably double the outreach indicated in the table, even allowing for client overlap. Nonetheless, if we accept that there are a billion-plus poor people in the world, representing up to 300 million poor households, then what Table 1 also tells us is that the task of bringing financial services to the poor is a long way from finished. At a rough estimate, between one-quarter and one-third of the target population of poor households in developing countries have access to the financial services they need to improve their lives.

If development NGOs are servicing a similar number of poor clients, closer attention must be paid to sustainability of access, competitive efficiency, and responsiveness to client needs-demand than is currently typical among development NGOs. Failure to pay closer attention to these issues will result in back-sliding into poverty by an increasing number of households, and make it even more difficult for poor households to graduate into the mainstreams of the financial sector in either the formal or the informal economy.

Table 2 summarises a set of key performance indicators (KPIs) drawn from 124 MFIs that cooperate with the CGAP-supported MicroBanking Standards Project. Updated data from this project are published in each new issue of the *MicroBanking Bulletin* (*MBB*). The data are disaggregated by mode of operation. Significant differences can be seen between those MFIs that operate using groups and those using individual loans. The latter tend to be MED programmes, with male operators of microenterprises dominating the loan portfolio. Group-based programmes need to charge far higher effective interest rates to achieve the levels of financial self-sufficiency of individual loan programmes. However, individual-based programmes are less efficient than group

Table 1 Overview of MFI activities in developing world, 1999–2000

Global client and MFI profiles	*Number*	*Outstanding*		*Average Portfolio*	
		Loans	*Deposits*	*Loans*	*Deposits*
		US$ billions		*US$ billions*	
IFPRI survey, 1999					
Borrowers (millions)	24	17.5		730	
Depositors (millions)	44		12.3		280
Total MFIs reporting[a]	1,400				
MicroBanking Project, 2000					
Borrowers (millions)	11.40	4.81		433	
Voluntary depositors (millions)	25.36		5.38		214
Total MFIs[b]	124				
Cashpor Network, September 2001[c]					
Borrowers	416,644	34.1		82	
Depositors	501,701		12.8		26
MFIs in network	20				
Benchmark MFIs in Asia[d]					
Grameen Bank					
Borrowers (millions)	2.2	360		156	
Depositors (millions)	2.2		186		85
BRAC					
Borrowers (millions)	2.6	218		84	
Depositors (millions)	2.6		58		22
ASA					
Borrowers (millions)	1.1	84		74	
Depositors (millions)	1.2		26		21
BRI, Indonesia					
Borrowers (millions)	2.5	1,500		600	
Depositors (millions)	16.6		1,245		75

[a] Total represents MFIs supported by international organisations only, including 688 in Indonesia and 790 in 84 other countries.
[b] Includes BRAC, BRI and ASA, but not Grameen Bank. Of the total only 15 are from Asia, not including Cashpor Network members.
[c] Grameen Bank replicators (does not include Grameen Bank).
[d] The MFIs shown are not necessarily the most efficient or effective, but are regarded as the leading institutions to which other NGOs look for replication models and guidelines.

Sources: International Food Policy Research Institute, Washington DC, Survey of worldwide MFIs, 1999; *MicroBanking Bulletin*, no. 6, April 2001; Cashpor Inc., *Credit for the Poor*, vol. 29, December 2000; DevFinance Network, Ohio State University; private communication, Asian Development Bank; websites for Grameen Bank, ASA and BRAC.

Table 2 Microfinance key performance indicators

	All MBB respondents	Methodology of loan operation		
		Individual	*Group*	*Difference*
Number of MFIs reporting	124	54	45	+9
% female borrowers	69	44	74	−30
Full cost recovery (% financial self-sufficiency)	76	102	84	+18
Number of clients per FTE staff	125	102	123	−21
Number of clients per FTE loan staff	280	229	271	−42
Total administration costs as % of total active loan portfolio	31	21	43	−22
Average loan as % of GNP per head (depth of outreach)	61	96	35	+61
Effective annual interest rate on loans (% portfolio yield)	39	34	41	−7
Salaries as % of total active loan portfolio	17	10	17	−7
% of loan portfolio at risk (in arrears >90 days)	1.9	2.5	2.1	+0.4
GNP/head as % of average FTE staff salary	16	18	18	–

Note: FTE = full-time equivalent.
Source: MicroBanking Bulletin, no. 6, 2001.

programmes in terms of clients per full time equivalent staff or loan officer. There is little to choose between the two in terms of repayment record, despite the fact that the average loan size relative to GNP per head for individual-based programmes is two to three times that for group-based programmes.

Core success factors

Success cannot be measured without reference to goals. Ten success factors are now presented. These are based on the assumption that for most social or community development NGOs the abolition of poverty takes precedence over the creation of a financially profitable MFI. Nonetheless, the adjustments to this list of success factors would be relatively minor even if the creation of a financially viable MFI were made an equally important goal.

1. Know your market

This is one of the first rules given to students of business commencing their studies. The rule is arrogant, but simple and powerful: there are only three things that must one must do to ensure the success of any commercial venture – (1) know your market, (2) know your market, (3) know your market. This rule is the foundation stone of all other success factors, including programme design, product design, service delivery methodology, pricing policies, growth strategies and programme KPIs.

NGOs that are not specialist microfinance providers must feel that the experience they have in working closely with their target audience gives them a significant advantage in understanding the 'market' for financial intermediation services. In some cases, this is indeed so. In others, possibly most, people of good will act on the assumption that they understand what is needed and proceed to implement a programme that seeks to replicate what others have done. The reality is that there is always a need to adapt even the most successful models to local socioeconomic, cultural, institutional and political circumstances. In all cases, however, the principle of subsidiarity should rule. All things that can be done by the target community should be done by them.

2. Lead with savings

It cannot be stressed enough that savings and credit are merely two sides of the same coin (see Rutherford 2000). One does not, therefore, have to begin with credit. SafeSave in Bangladesh is a good example. There is a presumption in microfinance folklore, drawn from the example of prominent programmes (such as Grameen Bank and ASA in Bangladesh, BRI in Indonesia, TSPI in the Philippines and AIM in Malaysia), that credit is a core essential. This presumption is false, as every successful ROSCA demonstrates.

At the heart of microfinance is the need to deliver those financial services and products that are needed and wanted by the target client group. If a programme focuses exclusively on credit it must do so only because this is what the market demands. One important reason why so many NGO-based microfinance programmes are unsuccessful in reaching the poorest of the poor is the failure to recognise the need to offer more than credit services. The absence of savings products causes the poorest of the poor to hoard what little money they have. Hoarding robs them of a rate of return on their cash holdings, strips their cash savings of value as inflation eats away at spending power, and fails to consolidate household assets into income generators. Well-designed microfinance savings programmes can overcome each of these obstacles.

There is, however, another reason why it is important to begin the delivery of microfinance services to any given client with savings rather than credit. This is 'best practice' risk management. The issue of repeat business aside, microfinance is built on the philosophy that no person should be forced into a cash flow management strategy that is beyond his or her capacity to service. Hence, in the initial period of client contact, it is prudent management if the programme does not lend more than the borrower can afford to repay, irrespective of what the borrower does with the money borrowed. The lender should be confident that the amount borrowed can be repaid because it has not exceeded the limit set by the capacity to save.

3. Concentrate on your best clients

The overwhelming majority of clients of NGO-based microfinance schemes are women (see Remenyi 2001, Todd 1996, Versluysen 1999, Yaron 1994), except in MED programmes using individual loan methodologies. Solidarity group programmes are overwhelmingly female in membership. Does it follow that NGOs seeking to become microfinance providers should restrict their programmes to female clients?

For most NGOs the predominance of female clients is evidence that women are the *best* clients. Women are more reliable in repaying, they tend not to 'over-borrow' as much as men, and they are most keen to retain repeat borrowing privileges. Experience also shows that women mostly use their loans in ways that spread the benefits across children and family members.

4. Follow the principle of subsidiarity

Mainstream banks fail to serve the poor in part because of the burden of internalising all the transactions costs associated with financial intermediation. This practice makes for high overheads and expensive servicing of clients. Microfinance providers need to avoid this trap by 'outsourcing' as many of the transactions and administrative processes as is practicable and consistent with good risk management. Essentially, this involves embracing subsidiarity strategies that nurture leadership and responsibility skills among the target client group to the lowest level possible. Hence, only internalise those functions that are essential to ensure (a) optimal risk management, (b) cost savings that do not compromise programme goals and quality control, or (c) functions that serve to enhance transparency and protection against losses due to the existence of moral hazards.

5. Keep it frequent and small

The essence of being 'micro' must never be sacrificed to the desire to grow into something big. Two related issues are critical here. First, microfinance works for poor people when it meets their need for a financial intermediary able to handle very small sums of money frequently, sometimes on a daily basis. Second, predictable and timely contact with the target client community is an essential ingredient in effective money management by the poor and in prudent risk management by the microfinance provider. Both are core characteristics of traditional village moneylenders, who accommodate small transactions and know their clients well through oft-repeated contacts. Frequent contact is especially essential if the target community is itinerant or forced to be mobile because they are squatters or displaced persons, as is the common case with newcomers to a slum or poor people living on the streets because they have nowhere else to live. It is evident from outreach data (such as in Table 1) that MED-focused programmes, including banks such a BRI in Indonesia, tend to have higher average loan sizes, while NGOs have the least capacity to fund lending activity from participant deposits. This observation notwithstanding, it remains true that NGOs have a better track record in outreach to the poorest of the poor because they are able to offer financial services managing the smaller range of transactions on a frequently and predictable schedule (see Dichter 1999:esp. 4, 8).

The essence of specialising in 'small' transactions refers to the ability to service the need that the poor have of a financial intermediary able to take small deposits, make small transfers and provide small loans. This is exactly what the mainstream financial institutions have been unable to do. The temptation will always be to up-scale the size of the average transaction so as to contain transaction costs. Some NGO programmes commit themselves to group-based strategies of financial service and product delivery precisely because groups enable the NGO to wholesale funds transactions to groups, which take responsibility for much smaller savings collections, on-lending and individual financial counselling. NGOs that eschew the group-based approach typically have a far higher average transaction size and limit the choice of transaction to a predetermined schedule of loans linked to defined debt repayment and savings behaviour.

Both group-based and individual-based programmes must maintain small transaction windows if they are to succeed in reaching out to genuinely poor 'new' customers. Even among established customers from the lowest levels of the poverty pyramid, who may be into their second, third or even fourth loan cycle, the size of transaction will be small. There are no hard and fast data showing how many deposit and loan cycles it takes for genuinely poor clients to improve their circumstances and climb above the poverty line as a result of regular access to microfinance services. However, anecdotal evidence suggests that the number is not small and may be in the 10–20 range, covering a 3–10 year period. Clearly, patience and persistence are essential.

If an NGO microfinance provider is to be truly successful, therefore, it must not only achieve growth through outreach to more and more small transaction-based new entrants into its client base, but also service its repeat business programme. Repeat business will typically involve rising average transaction sizes, with loan levels well above those associated with outreach to new clients. However, funding of the repeat business side of financial services provided must increasingly come from internally generated funds priced at market rates of opportunity cost. In terms of KPIs, the NGO can monitor its performance in achieving this goal by ensuring that the proportion of its repeat business funded from deposits and interest revenue generated increases in step with the growth of repeat business. Over time, this will free donor funds for the expensive business of reaching out to new clients drawn from the lowest ranks of the poverty pyramid.

6. Honesty and integrity are essential

There are few things that will destroy the sustainability of a microfinance programme more quickly than the perception among borrowers and depositors that the institution and its staff do not have the client's interests at heart. Hence, it is essential that management vigilance and staff development should avoid even a hint that the programme is benefiting staff at the expense of clients. Petty theft and corruption undermine the discipline that loan clients must have to ensure that on-time repayment rates remain in the 95–99 per cent range.

7. Poverty targeting is essential

There is a great deal of debate around the role that poverty targeting ought to play in the business strategies of MFIs and MED programmes. On the one hand, there are those who argue that a MFI will have greater success in its outreach to the poor if it has an open door policy and services anyone who wants to comply and become an active borrower and depositor (see, for example, Richardson 2000, Remenyi, 1991, 2001). There is some sense in this, especially where repeat borrowers are concerned. The principle basically is that MFIs are just as subject to the laws of increasing returns to scale as are the mainstream banks, insurance companies and other financial services providers. On the other hand, there are those, led by Dr Yunus from the Grameen Bank, who argue that the 'scale' effects of an open door policy do not outweigh the losses to outreach to the poor that are associated with the leakage of a rising share of the loan portfolio and other services to meet the needs of those clients who are the least poor or the no-longer-poor.

There are valid aspects to both points of view. If servicing the needs of the poorest of the poor is not your primary goal, but sustainable servicing of the financial needs of poor people is, an open door policy is likely to be the preferred strategy. One can even argue that it is enough to ensure that operations are essentially confined to clients drawn from below the poverty line, because there is a trickle-down effect to the lower strata of the poverty pyramid. However, research done by Todd (1996), and others, suggests that the trickle down is minimal. If an NGO genuinely wants to reach out to the poorest of the poor, it has to do so deliberately and strategically. One such strategy is to ensure that management embraces the challenging KPI of a rising share of the repeat-business loan portfolio financed from deposit growth and revenues earned.

8. Commercially efficient management is essential

Microfinance providers tell their clients about 'financial discipline', so that they will learn the importance of remaining true to their financial commitments and responsibilities. However, it is also essential that providers are as 'bankable' as their clients. Continued dependence on subsidies from a donor network does not encourage 'financial discipline'. Donor subsidies allow management to persist with overstaffing and to escape from the rigours of financial discipline. Deliberate action to the contrary is essential if these institutional vulnerabilities are to be avoided. If it is to do its job well, an NGO microfinance provider can be no less diligent in adopting commercially efficient KPIs and management strategies than MFIs without the benefit of subsidised donor support. Strategies to manage risk are at the heart of successful microfinance and MED. These strategies begin with being demand driven, and end with delivery systems that are least cost and antithetical to waste.

9. Participatory risk management is a must

There are many approaches to risk management, but in microfinance and MED there is no better guide than systems that exploit knowledge that is intimate to the community being served. There must always be a strong element of trust that people will normally do what is in their own best interests. But it is foolhardy to assume that people exposed to the duress associated with poverty will put community interests ahead of personal or family obligations. Consequently, while good risk management will utilise information drawn from community consultations to assess the trustworthiness of potential clients, risk management is also about designing procedures for debt repayment and savings collections that are consistent with the money management needs of clients and their efforts to escape poverty. Invariably, risk management is tied to patience, moving at a pace that is in line with what the client group can manage. A critical safeguard and source of client confidence in the programme that also contributes to risk management is strict transparency of each and every transaction, so that participants develop a sense of understanding and trust in the programme and its staff.

10. The poor do not need charity, they need good products and service

We honour the poor when we give them quality. We dishonour them when we do not give them our best. Charity has its place, but this place is not in any sort of self-help programme. Development thinkers have for too long ignored the cancerous manner in which 'charity' has created and nurtured dependency among the poor and kept them from being able to escape their poverty. Poverty is a justice issue. Poverty is a systemic problem. Poverty cannot be overcome on any sort of sustainable basis while the survival strategies of the poor are underwritten by charity. Microfinance and MED are powerful aids to escape from poverty precisely because good money management needs to be sustained, it is not a once-off thing. And sustainable microfinance cannot be achieved unless it is weaned of its dependence on charity.

Conclusion

Development NGOs are community builders first and foremost. In microfinance for poverty reduction, however, it has also been evident that institutional innovations that secure on-going access to financial services is a key component of sustained poverty reduction. In this sense, *success* cannot and should not be measured without reference to goals that include impacts that are both immediate and long-term.

Charity is not a foundation on which anything more than relief can be built. (Rhyne, 2001). A 'welfare' approach to microfinance and MED does not sit well with sustainability, growth in self-reliance, or the priorities and commercial practices approved by the many donor agencies that are ready, willing and able to fund microfinance activities. If access to donor funds for these purposes is a goal, the welfare approach to microfinance is not appropriate and will very likely do clients a serious disservice. Access to mainstream financial services must be assumed to be at commercial rates. If the clients that an NGO serves come off programmes that are provided at subsidised rates, it will be all the more difficult for them to migrate or graduate into the commercial mainstreams. Hence, if mainstreaming clients into existing financial systems is a goal, strategies have to be adopted that will remove any dependence that clients may have on subsidies, poorly designed products and services, or practices that do not enable poor households to achieve levels of self-reliance typical among households able to keep themselves above the poverty line.

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ASA: Profile of a successful microfinance institution

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Introduction

ASA, the Association for Social Advancement, is a Bangladeshi NGO, the acronym for which spells the word ‘hope’ in Bangla. ASA specialises in microfinance and is one of the largest and fastest growing microfinance institutions in the country. It differs from the Grameen Bank in its approach to individual clients and its focus on the mobilisation of voluntary savings. It represents a successful model recognised internationally as a self-reliant and financially sustainable institution that is being replicated in several countries and is contributing to capacity building for poverty reduction and rural development at home and abroad.

A replicable model

ASA is accredited by the UN Development Programme (UNDP) as an International Technical Service Provider in the Philippines and Nigeria under the MicroStart Program. It has also channelled almost US$39 million in loans to poor households, since November 1996, through the World Bank funded apex microfinance wholesaler PKSF, a government body set up to support microcredit providers in Bangladesh.

Although ASA was founded in Bangladesh in 1978, soon after independence, it did not start its microcredit programmes until 1992. Since then, it has disbursed US$635.8 million in loans to 1.33 million poor families, (around 6 million people). It has done this through 950 branch offices, covering all 64 of the country’s districts. At 30 June 2001, ASA had 1,194,969 active borrowers and 1,332,275 depositors, 95 per cent of whom in both cases were women. Loans outstanding amounted to slightly more than US$92 million, with the on-time repayment rate above 99 per cent.

The ASA model is different from that of the Grameen and other operations. Its self-developed character makes it unique among MFIs involved in the difficult task of poverty alleviation. The different characterisation of the ASA model can be summarised as follows:

- Programme approach: A single focus programme concentrates on providing financial support to its clientele. ASA operations do not mix with other non-financial services.
- Group formation: Client selection, group formation and approval result in prompt service and also increase the accountability and capability of staff involved.
- Group discipline: This follows client-friendly rules that ensure free interaction and client participation in implementation. Management also encourages staff to behave with clients as if they were a family member. No guarantee of loan by fellow members.
- Financial viability: Self-sufficiency and viability take 9–12 months.
- Source of funds: Funds include a large proportion (about 70 per cent) of interest-carrying loans, which supplement donor resources.
- Savings mobilisation: More emphasis is placed on savings mobilisation in order to widen the resource base for growth as well as to create alternative sources of capital for clients. A competitive package of savings products is offered, enabling clients to save with profitability as well as in different seasons.
- Fund costs: ASA loan funds cost 3–4 per cent more than those of other operations.
- Operation costs: These are minimal at 4.5 Taka per 100 Taka loan (56 Taka = US$1).
- Transaction costs: Field offices are close to clients, reducing transaction costs for both organisation and client. This also substantially improves monitoring, supervision, problem identification and the taking of corrective measures.
- Fast expansion: ASA attracts more clients than other operations. In seven years, it reached about a million clients.
- Decentralised decision-making process: By adopting a responsive policy through delegation to branch levels, ASA ensures prompt decision making.
- Supervision: The span of control of field workers is kept at around 4–5. Fifty per cent of field worker actions are cross-checked by a supervisor.
- Information system: All transactions can be cross-checked and examined on a daily basis. This forms the basis of routine monitoring and control, triggering managerial action.
- Accounting and administrative procedures: Following procedures that rely on standard rules has been simplified by the introduction of a manual/ guide book. Using this, branch offices do not require approval to take decisions on daily activities and are able to perform their regular accounting without need for a professional accountant.
- Hierarchy: The provision of a regional manager and a divisional manager, without separate office and support staffs, makes operations more cost effective.

- Training of new staff: An initial 9-day orientation has been found to be adequate for developing the basic capacity needed to start working on a full roster.
- Cost management at branch level: Branches are three-room establishments: one for the office and two for residence. There is no need for a security guard. There is a standard set of furniture, with other utilities and office supplies. These are documented in the manual and have price caps.
- Fund management: Branches can transfer money among themselves within a region with regional manager authorisation. In this way, funds can revolve at a higher rate, with a maximum revolving effect on capital.
- Accessibility: As branch structure is small, simple and operationally cost effective, it allows easy access to remote areas, thereby increasing outreach capacity.
- Loan approvals: As the branch manager has the authority to approve loans, clients can obtain a second loan immediately after full repayment of the first.
- Group or group trust funds: ASA does not use any portion of the sanctioned loan to constitute a group or group trust fund.
- Number of loans per client: The single loan policy helps to keep a client's financial burden to a minimum and also ensures proper utilisation and easy repayment.
- Savings withdrawal: Members can save as much as they want and can withdraw savings, keeping 10 per cent against their loan. Both savings deposits and withdrawals can be made at members' premises.

In 2000, ASA was externally reviewed by a team consisting of Graham Wright (from MicroSave Africa), Robert Christen (from CGAP), and Imran Matin (from World Bank). They concluded that 'ASA is financially sustainable and provides financial services to 1.5 million poor people. It is among the best managed, large-scale, sustainable, microfinance providers anywhere in the world' (Wright et al. 2001:1).

The importance of consultation and monitoring

The external review found that part of ASA's success can be attributed to the importance it places on close monitoring of its activities. The monitoring system is designed in such a manner that it is inclusive of staff. Regular coordination meetings are held at all levels of the organisation. Policy matters are shared and decisions made after elaborate discussion of the issues. 'The entire ASA system is controlled and driven by directives sent out from Dhaka . . . on the basis of discussions with field staff in regular coordination meetings and field visits by senior staff, which are used to monitor and review ASA's policies' (Wright et al. 2001:2). Central to this monitoring is the verification of records in branch offices. The accounting system acts as the source of all information. Area managers and divisional managers are responsible for monitoring branch office activities.

Management monitoring is conducted on a regular basis by a Management Monitoring Cell in the central office, which reports directly to the managing director. Programme monitoring occurs through the Coordination and Implementation Cell. Four general managers, each with well-defined responsibilities, report to the managing director with whom they regularly share problems, policies and activities for quick decision making, programme implementation and smooth functioning of the organisation. The cell is responsible for selecting activity areas, developing job descriptions for field workers, submitting annual plans and implementing and coordinating the programme component according to an operational plan. The general managers check and approve monthly savings and credit reports, monthly receipts and payments accounts, and also arrange monthly coordination meetings. The members of the central monitoring teams visit the field three times a month and each of them is required to spend at least 15 working days a month checking branch activities. Monitoring checklists have been produced by ASA to 'regularise' the process for easy management purposes. The findings, along with recommendations, are presented to the managing director for immediate action.

ASA listens to field staff

Central office managers make regular trips to the branches to discuss new policies and concerns. This frequent dialogue is indispensable to the task of keeping the central office in tune with what is happening in the field.

At central office coordination meetings, senior staff members discuss new policies, or changes to existing ones, in detail before deciding on implementation. Once a decision has been made, a circular is sent to each branch and the policy change has to be incorporated into branch operations within a month. Coordination meetings and communication through circulars and frequent field visits help to keep ASA dynamic. Central office also arranges the half-yearly area and divisional-level staff coordination meetings, at which reports on activities are produced, staff performance evaluated and plans for the future made.

ASA's monitoring system ensures that the operations of the MFI are transparent to all levels of management, which helps to ensure that all staff are pulling in the same direction, that management remains open to innovation, and that proposed changes can occur in a rapid but informed manner.

The ASA operating system

ASA has a highly 'delegated' operating system. Authority for a wide range of administrative and programme related decisions, including loan approval, disbursement and fund management, has been given to branch offices. This business model has ensured that decisions are quick, fund utilisation is efficient, financial planning is proper and field-level operations are appropriate to local circumstances. The operations manual, a copy of which is provided to all staff, is an important source of guidelines and is central to staff induction and training.

Cost control is taken very seriously and the organisational structure has been standardised to facilitate it. Every branch office is furnished with uniform furniture and equipment, and a standardised operational budget for rent, other furniture and equipment, electricity, gas, water, stationery, entertainment, and postal, telecommunication and courier services. Target performance ratios are also standardised in an effort to ensure low-cost supervisory structures and minimal overhead costs.

Process of implementation in a branch

1. A branch is structured with a branch manager, four credit officers and one support staff. Activities are conducted with around 1,800 clients across 72 groups, with each group comprising 20–30 members. Savings deposits, withdrawals and repayments are done in the weekly group meeting. Each credit officer is responsible for 18 groups in a week (three groups daily).
2. From the first week, a member deposits weekly savings of at least Taka 10, or a larger amount depending on her capacity.
3. After four weeks, the member receives a loan with a 15 per cent (flat) service charge, repayable within one year (46 weekly instalments).
4. The distribution of credit among the 1,800 clients is completed within 4–6 months of a branch starting up. The service charge makes it possible to meet management and financial costs and a certain percentage of loan loss provision within a year.
5. The branch manager remains responsible for implementation of activities with the credit officers and under the guidance of a regional manager.
6. The branch manager is authorised to approve clients, groups, loan size, office expenses, and so on, under the manual guidelines.
7. The branch manager plus two credit officers operate the bank accounts.
8. The branch manager and an assigned credit officer perform the responsibilities of accountant and cashier, respectively. There is no professional accountant, owing to a very simple bookkeeping system.

Sources of growth

Dependency on donors has been avoided through the mobilisation of local resources in the form of different savings products. The withdrawal of savings has been made possible through the introduction of a voluntary savings programme.

Foreign donations fell from 36.23 per cent in 1994 to 14.35 per cent at the end of December 2000 (Table 1), when donor funds ceased. Since then, ASA's soft loan on interest from PKSF has increased. Savings deposits grew as ASA followed the lock-in mandatory savings policy and decreased as the voluntary savings programme was introduced. More savings are deposited in favourable seasons and withdrawn in times of scarcity.

Table 1 Sources of funds for ASA microfinance services, 1994–2000

Source	*2000* %	*1999* %	*1998* %	*1997* %	*1996* %	*1995* %	*1994* %
PKSF	28.77	29.93	23.71	21.76	11.31	9.33	8.63
Bank loan	0.00	0.42	0.34	0.52	0.35	0.63	0.00
CORDAID	0.40	0.51	0.00	0.00	0.00	0.00	0.00
Member savings	28.92	29.22	36.56	36.91	36.74	31.04	30.46
Member insurance	1.29	1.71	2.07	2.84	4.23	4.48	3.05
Loan loss reserve	3.59	2.94	2.10	1.26	1.02	1.27	0.93
Emergency fund	4.79	3.66	2.77	1.58	0.00	0.00	0.00
Others	1.73	1.79	2.29	3.97	5.40	5.65	5.19
Sub-total Taka	***69.48***	***70.20***	***69.84***	***68.84***	***59.04***	***52.41***	***48.25***
Capital or equity							
a. Donation (foreign)	14.35	17.31	19.79	21.49	29.05	33.36	36.23
b. Service charge	10.50	7.98	5.84	4.79	6.69	8.43	9.17
c. Other income	5.67	4.51	4.52	4.88	5.22	5.80	6.35
Sub-total Taka	***30.52***	***29.80***	***30.16***	***31.16***	***40.96***	***47.59***	***51.75***
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Since 1993 ASA has covered all costs from the income generated from its microfinance services, and all donor grants, either operation cost or grant capital, are considered as equity. Thus, ASA has succeeded in avoiding donor assistance and has established itself as a financially self-sufficient MFI.

Reference

Wright, G.A.N., R.P. Christen and I. Matin 2001, *ASA's culture, competition and choice: Introducing savings services into a microcredit institution*, MicroSave-Africa, Dhaka.

Microfinance regulation in South Africa: A comparative perspective

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Introduction

In its treatment of small-scale financial services, as in many other things, South Africa is different. Its experience provides a uniquely useful perspective on policies and institutions aimed at economic development and poverty alleviation. This article focuses on the environment for low-end financial services, and in particular the regulation of microfinance. A review of experience in South Africa helps to illuminate the differences between rich and poor country financial sectors, rationales and approaches to the regulation of microfinance, and the importance of social context for work in this area.

The microfinance market in South Africa

The governance practices of the apartheid era in South Africa helped to create a highly fragmented financial market (see Meagher and Wilkinson 2001). On the one hand, a strong informal system of credit, from traditional moneylenders (the mashonisa) to stokvels (traditional funeral savings societies) and rotating savings and credit associations, existed in parallel to the formal banking system. The informal system was not organised to support entrepreneurial requirements. Instead, it dealt with consumption demands, consistent with the restrictions of property ownership and entrepreneurship to certain groups.

Formal financial services, on the other hand, were highly constrained and concentrated, with a few increasingly integrated financial groups dominating the market. The only widespread financial services offered were small savings accounts and, for the formally employed, direct salary credits to deposit accounts. Under such circumstances, employers often found themselves operating as lenders of last resort by providing employee advances. Banks, insurance companies, building societies, and other formal sector financial institutions did not serve the bulk of the population. Understandably, there was antagonism between such institutions and those now designated 'previously disadvantaged South Africans'. Thus, most people distrusted the institutions most able to provide investment and business-related services. Availability of funds depended on trusting personal relationships between borrowers and lenders/members, or on the security of pawned goods. Informality in the low-end market, moreover, went hand-in-hand with evasion of the Usury Act.

Regulatory change

In 1992, the government decided to create an exemption to the Usury Act, allowing loans under R6,000 to be provided without any interest rate restrictions (8.5 Rand = approx. US$1). This allowed self-capitalised lenders to provide loans without such limitations, causing rapid growth and expansion of more formal services to this market. In 1999, after a great deal of intragovernment discussion and pressure by consumer and SMME (small, medium and microenterprise) interests, a revised Exemption Notice came into force. This defines the category of exempt moneylending transactions as those not exceeding R10,000, payable within 36 months, and excluding credit card schemes or overdrafts on cheque accounts. Lenders are required to comply with the rules and to register with an authorised regulatory institution in order to be exempt from the interest rate controls of the Act, hence to freely determine their rates.

The Micro Finance Regulatory Council (MFRC) was established as an authorised regulatory institution under the Exemption Notice. Microfinance institutions (MFIs) operating under MFRC supervision are credit-only and not authorised to accept retail or wholesale deposits. As such, they are not required to meet prudential ratios. On the other hand, they must report on a regular basis to the MFRC, which checks their adherence to management and consumer protection standards, responds to complaints, and reports to government and the public. Outside auditors are used for annual on-site inspections, and quarterly returns and reporting of credit data to a national registry are also required. MFIs must re-register annually. Loan term disclosure and other consumer protection rules apply, and certain collection procedures used in the past (retention of bank cards, use of blank court process documents) are outlawed. These rules aim to regularise and legitimise for-profit microcredit services, to balance the rights of the parties and, in doing so, to promote a growing microfinance sector. The MFRC, although it does not have formal powers over unregistered lenders, has sought them out on its own initiative and facilitated formalisation by offering a transition path by means of provisional registration.

The MFRC has registered 1,334 institutions with a total of 5,051 branches. Of these, the MFRC manager advises that re-registrations are down 20 per cent from 1999–2000. This drop is believed to be due to smaller microlenders being bought out, merged or wound up. Another factor may be to avoid the costs of regulatory compliance. Registered microlenders have disbursed a total of approximately 10 million loans, and the gross credit outstanding is about R14 billion. Banks hold most of the (formal) term loans, and they have aggressively developed this market using their deposit bases. Estimates of the value of unregistered microlenders' operations range anywhere from 10 to 50 per cent of that of registered firms.

Formal lending for housing and SMMEs has grown substantially as the market has evolved but represents a smaller than anticipated proportion of total lending in the microcredit market. The total number of housing loans reported by registered microlenders was somewhere between 360,000 and 809,000, with total disbursements of between R2.6 and R6.3 billion, based on MFRC estimates. SMME finance was reported by 418 registered microlenders, who provided 153,000 loans totalling R155 million. Khula Trust, the parastatal refinance body for the SMME sector, has a loan portfolio amounting to approximately R130 million, and in all has financed some 750 businesses. These totals fall well short of estimated SMME credit needs. Fortunately, a significant amount of consumption credit is also reported to be used for SMME and housing purposes; for example, African Bank estimates that 38 per cent of its consumption loans are used for housing.

Current status

The MFRC regulatory regime has created an environment in which large and small lenders have a real interest in extending finance to the low-income market. This has led to product innovation across a broad front, including housing and SMME finance, better savings products, and an expanding network of financial institutions accessible to low-income groups. Specific results to date include: (i) formalisation of the microloan industry, as institutions are encouraged to register and report, and as registered violators are punished for non-compliance; (ii) consolidation, as the smallest lenders, unable to expand due to lack of funds, sell their 'loan books' to competitors; (iii) new investment by the banks in microlending subsidiaries; and (iv) substantially expanded credit through both lenders and retailers, leading to increased consumption spending as well as to mounting indebtedness and debt spirals.

There are several aspects of the South African microloan market which distinguish it from microfinance markets in most developing countries. In countries where microfinance is growing rapidly, the focus is on clients at or below the poverty line who wish to borrow for income generation or microenterprise. Accordingly, clients are largely rural, female, relatively poorly educated and lacking alternative sources of credit or secure savings systems. The average microfinance client in South Africa, by contrast, is an employee of a government or private sector institution, who is paid through a bank savings or 'transmission' account but who cannot obtain a bank loan. These individuals probably have few or no side businesses for extra income; loans are therefore unlikely to increase household income streams.

Repayment mechanisms differ as well. There is a significant degree of social fragmentation and mistrust in South Africa, particularly in urban areas where clients are most likely to live and work. Therefore, microlenders place much importance on securing repayment directly from the most certain and predictable income stream: the payroll, or, if that is not possible, the salary account in the client's bank. These mechanisms thus replace the detailed and costly knowledge of client circumstances and group reinforcement that MFIs in other developing countries rely on. Even though the repayment system seems secure, in practice it is not. Cash (short-term) lenders report loss rates of approximately 10 per cent on their monthly portfolio. In some cases, employer payroll clerks and bank clerks are reportedly paid bribes to prioritise a microlender's debit request.

Major policy challenges

There are several major constraints to responsible growth of the low-end credit market in South Africa. Policy makers are currently studying these issues and formulating responses. The problems fall into four categories: inappropriate structuring of the financial sector, stringent limitations on MFIs' ability to access funds for on-lending, undue complexity in the regulation of financial institutions' operations, and shortcomings in the design of complementary institutions affecting the efficiency of credit markets. Such concerns affect the development of financial sectors everywhere, although the specific dynamics tend to be quite different in the poorest developing countries.

Financial sector competition and tiering

Services at the lower end of the South African credit market are severely limited, with most banks focusing narrowly on the high end. That restricted competition plays a role is suggested by the fact that some 75 per cent of banking assets are concentrated in the top four banks, and 88 per cent in the top six; and average spreads and returns are comparatively high (5 per cent after inflation, compared with 3 per cent worldwide). South Africa has a longstanding need for market deepening.

There remains a 'missing middle' between commercial bank lending and microcredit; that is, there are virtually no commercial or housing loans in the range between R10,000 and R100,000. The development of a significant 'second tier' of deposit-taking institutions to serve this market segment has been on the agenda but has proven difficult to implement. This was the motivation behind the Mutual Banks Act of 1993, but it provided an inappropriate model. The minimum capital requirement under the Act is still a serious constraint (R50 million, compared with R250 million for banks). The challenge is to adapt the banking structure, or to stimulate the growth of new kinds of institutions, to serve a large population living on low incomes and with few assets that can be used to raise capital.

One concept of tiering defines additional levels of deposit-taking institutions by setting a lower minimum capital floor, while limiting activities under the institutional charter; placing caps on loan sizes or overall assets; and/or tightening prudential standards in such areas as capital adequacy ratios, asset risk-weighting, and loan loss provisioning. Such an approach links tiering to differences in liabilities of different categories of institutions, that is the extent to which the source of funding is the general public. Different thresholds of financial intermediation activities trigger different mandatory prudential guidelines.

Tiering is best done parsimoniously, in close relation to actual developments in the market. Regulation and supervision are expensive, subject to a host of principal-agent failures such as corruption, and therefore of uneven quality and limited supply in most countries. Regulation and supervision should therefore be used sparingly, hence carefully focused on high priorities. This means deploying them in the areas with the highest pay-offs in terms of systemic risk mitigation, protection of depositors, efficient intermediation and responsible growth. Setting up tiered systems is usually an important aspect of this. However, there is always a danger of overreaching, pushing the market too hard by extending state guarantees to a host of market niches through a proliferation of regulatory windows.

Diverse approaches have been taken to the design of financial sector tiers. The approach in the industrial countries defines separate tiers of limited charter institutions, often locally owned, such as thrifts, building societies, mutual banks or savings banks. In recent years, these institutions have been brought under some elements of law and regulation common to all banks, and many have converted to corporate form and sought to compete directly with commercial banks.

Developing countries such as Bolivia, Indonesia and Peru have created some form of middle or lower tier institution, and some also include parastatals supplying credit at the wholesale or retail level. Some (such as Peru) have formalised a large number of tiers, while others (such as Bangladesh) have kept them to a minimum while facilitating the growth of MFIs within evolving frameworks of private and self-regulation. Most formal tiering systems are designed so that regulation tightens, and supervision intensifies, as institutions draw on public deposits and potentially impinge on the payments system. Some systems (for example, in Ethiopia and Ghana) contravene this principle by bringing credit-only institutions under direct supervision. However, these systems clearly allow for differential treatment in a way that keeps the strongest emphasis on deposit-taking institutions. The question that critics have raised is whether the costs of taking responsibility over non-depositary institutions outweigh the benefits of helping to stabilise the microfinance market and providing a graduation path towards deposit taking.

Sources of loanable funds

All financial institutions in South Africa that are not registered as commercial banks face a problem of severely constrained access to funds for on-lending. This particularly affects the SMME and low-cost housing finance markets. The source of this problem lies in the broad definition of deposit taking in the legislation. The definition includes the receipt of funds from any source other than banks, shareholders, members of common-bond institutions and family members, and the legislation restricts deposit taking to banks (and a few others under specific exemptions). This has made access to funds for microlenders very difficult.

There are some additional factors contributing to this funding constraint. Microlending is a new market and thus equity investments have been difficult to generate. A few of the largest microlenders have floated shares on the Johannesburg Stock Exchange, but the minimum capital and documentation requirements for public offerings put this approach out of reach of smaller institutions. Also, refinance mechanisms such as factoring and securitisation are underdeveloped and costly. The parastatals unfortunately have not been able to take up the slack. The National Housing Finance Corporation has provided refinancing facilities, but the size limitations on the loans have reportedly created difficulties. Khula Trust has not lent significantly in the microcredit sector due to the consumption focus of many lenders. Also, low savings rates and the lack of incentives for depositors have helped to constrain the supply of loan funds.

The funding constraint for MFIs has been recognised by South African policy makers, and the process of designing innovations is underway. In cooperation with the Reserve Bank, the MFRC has developed proposals for regulations that would enable selected non-banks to accept wholesale deposits above a minimum amount for individual deposits (R500,000 or 1 million), and below a maximum for overall deposits (R150 million), and provide improved securitisation procedures, including risk information for investors. Corporate governance and securities market oversight should provide sufficient discipline, without the need for central bank intervention.

Regulatory structure

A microfinance regulatory system must address the questions of who is regulated, by whom, and what kind of regulation is applied. Many systems have found ways to exclude the smallest institutions, for which regulation makes little sense. Others (such as Bolivia) allow no formal exemptions, but make this workable by encouraging the downward integration of financial institutions into the microfinance market and by tolerating informals.

As to 'who regulates', there has been a development of hybrid and self-regulation systems. These range from a combination of apex oversight and self-regulation by NGO-MFIs (as in Bangladesh and the Philippines) to systems of shared oversight involving centrally determined regulatory standards and supervision by other entities (such as a federation of MFIs in Peru, a parent financial institution in Indonesia). The MFRC is another version of this. Experience with hybrid systems has been varied, with delegated supervision achieving good results, creditor and apex oversight leading to mixed outcomes, and self-regulation performing worst.

As to what kind of oversight is provided, it is important to keep in mind the distinction between prudential regulation and supervision, and other kinds of regulation. Prudential oversight places the supervisor in the position of vouching for the safety and soundness of the system, thus requiring the supervisor to make this credible through functioning systems of reporting and inspection. Supervision is a public good, but one that has been handled well by delegation (as in Indonesia): the financial regulator makes the rules but acknowledges the impossibility of directly supervising thousands of MFIs, handing this over to an entity with the systems and incentives in place to keep the system sound.

Another configuration is for government to hive off a range of non-prudential regulatory concerns, making special purpose bodies responsible. South Africa's MFRC is a leading example of a non-prudential financial regulator. At the far extreme of delegation (hardly delegation at all) is oversight by apex creditors and self-regulation: the bank supervisors do not vouch for the system, leaving this to the apexes and associations. The apexes have more consistent incentives in this regard, since they are not lobbyists for the MFIs that they oversee and they have a creditor's interest in ensuring sound portfolios.

South Africa's regulatory structure for microfinance is an anomaly in comparison to those of developing countries generally. This structure determines the authority of several regulators over financial activities based on whether the latter fit within the Banks Act, Mutual Banks Act, Usury Act, Credit Agreements Act, or an exemption to one of these laws. In particular, separating regulation of registered from unregistered microlenders creates an odd two-tiered microcredit market. Lenders who formalise under the MFRC incur the costs of registration and the limits imposed by regulation but continue to suffer from the competition of unregistered (and in effect unregulated) competitors. Little wonder, then, that evasion and regulatory arbitrage are common. South Africa is examining these issues in the context of an anticipated rationalisation of banking and credit markets involving a single financial 'super-regulator'.

Complementary institutions

The environment for microfinance also includes a range of complementary institutions and policies: the legal regime for secured finance, contract enforcement, general consumer protection systems, securities regulation, accounting standards, administrative accountability mechanisms, criminal sanctions against fraud and corruption, and others. The development of microfinance depends on the quality of these systems, although carrying out reforms in problem areas may be a long-term project.

Consumer protection concerns have taken on particular importance in South Africa. First and most obviously, South Africa's credit markets operate with the interest rate ceiling provided by the Usury Act, together with the current Exemption Notice. Analyses of the usury restrictions suggest that, far from protecting consumers, they usually restrict access to credit by individuals and firms with less than stellar credit records and no established relationships with financial institutions. This tends to push these credit-seekers into unregulated informal markets, where credit terms and the risks of abuse are far worse. These restrictions have especially affected investments in high-risk lending, such as for SMMEs. Many countries have relaxed or removed such caps in order to stimulate small or 'sub-prime' lending (that is, loans at high rates based on risk and/or lack of a credit record). Doing this effectively in South Africa poses a challenge, particularly given the enforcement problems and public perception of the need for caps.

A related issue is the increasing incidence of unmanageable consumer debt, made possible by easy access to debit orders. South African observers report large-scale abuse of various mechanisms: bank account debits, the retention of bank cards and PIN numbers, payroll deductions, wage garnishment orders, and attachment of pension funds. The forms of abuse include reckless overlending, fraud, and bribery of bank and payroll clerks. South Africa may need to consider limits and priority rules, as it has done in the case of state pension plans. Defaults by those with too-high debt burdens also act as a disincentive for lenders, indicating a need for a more debtor-friendly personal bankruptcy regime.

South Africa has also begun to consider ways to strengthen the transparency requirements and educational programmes that promote informed consumer behaviour. Unfortunately, the relevant laws fail to prescribe the form of credit term disclosure, to require all charges to be expressed as an effective annual percentage rate or total cost of credit, and to provide for explanations or cooling-off periods (except for the current Usury Act Exemption Notice). There will also need to be an effort to ensure that consumer protection rules apply to loan brokers and agents, as they do elsewhere.

Another major difficulty is posed by the laws and mechanisms supporting credit transactions. These transactions are relatively costly and difficult, due to the state of institutional development in such areas as secured finance law, debt enforcement and collateral repossession, insolvency procedures, and credit information systems. For medium, small, or micro loans, the only affordable types of security now are residential mortgages, pawns, and debit orders against bank accounts, payroll, and pension funds. South Africa's dated laws in this area provide a number of secured finance instruments, each with its own formalities and registration system. By contrast, countries with very large volumes of secured financing (such as the USA and Canada) have a simple uniform system for creating, registering and enforcing commercial secured credits.

Residential mortgages in South Africa suffer from special problems, including the fact that many SMMEs and low-cost housing clients do not own or have clear title to their premises. Even if they did, the sizes of the loans demanded in this market segment are reported to be so small as to be unprofitable for the banks. Also, foreclosure in the townships, where most such clients are likely to live, is believed to be unreasonably hazardous, if not impossible, and keeping a foreclosed property from being illegally re-occupied is equally difficult. Of the 300,000 recorded housing-related bank loans extended to township residents in the last decade, nearly one-sixth are non-performing.

Conclusions: A comparative perspective

The South African experience provides a unique perspective on the rationale, approach and social context of microfinance regulation. The sophistication, concentration and capitalisation of South Africa's financial service sector resembles that of industrial countries. Accordingly, response to the limited reach of banking services is also similar – that is, partial liberalisation of the low-end credit segment, along with state support for housing and SMME lending, and consumer protection rules aimed at 'sub-prime' borrowers. These efforts have expanded formal financial services from the white minority to a much larger group, but a large population of farmers and informal labourers is still left with access only to limited informal credit services and little in the way of savings mechanisms.

Why? We have seen that South Africa's banking sector is insufficiently competitive, and has incentives that are too weak, to serve the low end of the market. This problem goes along with a number of institutional constraints, such as a failed attempt to create a second tier of mutual thrift institutions, and inefficiencies in the governance of credit transactions. Microfinance development essentially takes these constraints as given, and attempts to deepen financial access through a combination of downward integration of formal services and enabling new and informal providers to grow upward.

A second set of conclusions concerns the approach to the development of microfinance regulation. Experts often treat this area as consisting entirely of whether and how the financial authorities should regulate and supervise MFIs. The South African experience shows why this approach is incomplete. To the extent that the formal system cannot meet the demand for low-end financial services, this is as much due to overall system governance, competition and the legal structure for credit transactions as it is to the configuration of bank regulation. This is not to suggest that decisions about microfinance policies should wait until all of these problems are addressed, but it does suggest the likely limits of strategies aimed solely at microfinance regulation and support. Moreover, South Africa's innovative regulatory agency, the MFRC, is a model that can probably be sustained only in relatively well-capitalised microfinance markets – which do not exist in most poor countries.

The South African experience also provides special insight into the social context of financial services. The fragmentation of its financial sector reflects the fragmentation of the society, and the constrained reach of the banking industry is a direct outcome of apartheid. Developments since the early 1990s have done much to improve the picture, but the legacy remains. It is especially difficult to sustain reform in an environment where banks are popularly viewed with suspicion, as guardians of the old order. In some form, many countries, especially in the developing world, face this problem. South Africa is grappling with it in ways that are sure to enlighten.

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Microfinance regulation and supervision in Zambia

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Zambia microfinance legislation and regulation

The Zambian financial system comprises the Bank of Zambia, which is the country's central bank, 15 commercial and merchant banks, 3 building societies, 21 insurance and pension firms, securities firms, and other non-bank institutions such as leasing companies, foreign exchange bureaus, and microfinance institutions (MFIs). Commercial banks at the end of 2000 held deposits of approximately K2,079 billion ($US547 million, where 3,800 Kwacha = $US1) and had loans outstanding of K970 billion (US$255 million). Non-bank financial institutions (NBFIs) held deposits of about K40 billion (US$11 million) and outstanding loans totalled K57 billion (US$15 million.)

The supervision of the financial system by the Bank of Zambia is presently handled in two market segments. The commercial banks are supervised by the Banking Supervision Department, while the newly formed Non-Bank Financial Institutions Supervision Department oversees all NBFIs under its legal purview, including MFIs. Securities firms, the Lusaka Stock Exchange, and pensions and insurance firms are regulated and supervised by other authorities, with coordination meetings regularly held between regulators.

Weaknesses in the microfinance institutional framework

Microfinance services are currently being provided in Zambia without regulation or supervision, which is historically consistent with the worldwide start-up of this market under unregulated conditions. Significant amounts of money are being channelled into this 'market without rules'. This lack of a legal and supervisory structure for MFIs means that checks on their operations or legitimacy are absent. Donors are providing funds without the usual checks and balances consistent with private investor behaviour. The result is a risky, rapidly growing, ungoverned sector with significant gaps in accountability, transparency, stability and efficiency.

Historically, the role that the Bank of Zambia should play towards MFIs has been unclear. This is because information on the industry is unreliable, and in many cases non-existent; nor has any MFI traditionally had much incentive to be transparent. This lack of transparency has also isolated MFIs from the natural linkages to banks and other financial institutions that are so common within the financial sector, and limited the important jump to local ownership and local investment in MFIs.

MFIs are now delivering financial services but are not supervised like other financial institutions. This has led to a number of problems, clearly reflected in the 1999 Bank of Zambia survey of MFIs:

- Although MFIs are committed to serving the poor, many do not focus on efficient, transparent, sustainable service provision.
- While some MFI professionals are honest, staff at other service providers are self-interested, sacrificing both economic efficiency and services to their clients in order to receive higher salaries and travel allowances.
- External reporting by MFIs to clients or investors seems either erratic or non-existent.
- There are cases of fraudulent persons presenting themselves as MFI officers, taking client money, and disappearing.
- Some donors give out money without sufficient safeguards, or in time periods and amounts or under conditions insufficient to ensure institutional soundness and self-sufficiency.
- Many clients are not provided with full information about MFI services, requirements and costs.

These findings represent unsafe and unstable conditions for borrowers, potential savers, and the public. With widely varying conditions of investment, it is also not a level playing field for MFIs. The issues listed above provide a persuasive case for immediate attention to regulation and supervision matters.

The Bank of Zambia will develop regulations and introduce a supervision process that enables responsible growth of microfinance services in the Zambian context for the long term. Ultimately, the goal is to broaden and facilitate the poor's access to affordable and reliable financial services, by creating room for every reasonable model of microfinance savings and lending to operate legitimately and fairly. These changes will allow microfinance providers to gain the systemic credibility to be able to borrow wholesale from domestic sources, and to gain the legal right to use client savings for loan expansion.

Benefits from improved microfinance regulation

The public is expected to substantially benefit from better microfinance market governance, in particular women under the poverty line who are the main clients of microfinance services. Poor women and men will be protected to a much greater degree from increasing circumstances of pyramid schemes, quasi-MFIs, and other forms of fraud. Clients can be more certain that they are making agreements with *bona fide* institutions. The registration process will provide a checkpoint where the poor can verify the legality of an MFI before placing funds. The regulatory system can also provide an avenue for recourse by people in case of unfair treatment or dispute.

The emphasis on transparency in the regulatory process, and the inclusion of a public awareness programme, will enable poor people to make informed choices about MFIs. Actual and potential clients will better understand their rights and obligations. With more transparency, confidence is likely to increase, leading to more actual clients for MFIs. MFI investors, required to commit themselves more significantly to programmes leading to full self-sufficiency, may be more careful about internal institutional governance. Financial services will deepen, a key factor in economic growth. With more opportunities to use financial services, a significant tool in poverty alleviation will be provided to Zambians.

If, as predicted, the microfinance industry becomes more effective and efficient as a result of judicious regulation and supervision, there are a number of potential spin-off benefits in the social sphere. First, those who most need them – poor women – will have better options for financing income-generating opportunities. Second, people are better able to plan for lumpy expenditures, such as school fees or business-related investments, if they have access to nearby savings services. Third, with regulatory responsibilities, compliance will require better management of MFIs, with subsequent better/more efficient services available for those that choose to stay in existence. Fourth, donors will also have an independent source of information on MFI operations and can accordingly assist their funded MFIs to reach compliance in a much more efficient manner.

Regulatory issues to be addressed[1]

Which options for microfinance regulation and supervision?

Until very recently, regulatory authorities have ignored the existence of MFIs. Regulators perceive that their operations are too small to pose a threat to the overall stability of the financial system. Where credit is extended and no deposits are collected, the collapse of the organisation poses no risk to its borrowers. Even when deposits are collected, depositors are often net borrowers and thus face little risk in case of organisational failure.

However, lack of market governance assumes that the market operators will function in an economically sensible manner. Evidence from the 1999 Bank of Zambia survey indicated problems with cost structures consistent with sub-optimal supervision by investors (largely donors.) In addition, market players themselves are asking for supervision to enhance legitimacy, enable links to other financial players such as banks for credit lines, and help prevent the occurrence of fraud in the market.

The first alternative to no regulation is self-regulation. In the early stages of its development, the industry may choose the option of setting its own standards and regulations. This may be useful where the authorities have no experience with regulating MFIs. Industry self-regulation is more likely to succeed if the MFIs share the same objectives and operational characteristics, such as being cooperatives, NGOs or credit unions.

The risks associated with self-regulation are twofold. First, it allows organisations to be vulnerable to political pressure. The once-strong credit union movement in Zambia was unable to resist governmental insistence that cooperatives be agricultural input conduits. This caused widespread failures as clients refused to repay what they deemed government largesse. Second, it tends to be vulnerable to whichever institutions have the strongest voice, whether due to size, financing or local influence. Therefore, where there is diversity in size, scale of operations, objectives and resources, setting common standards might be difficult to achieve.

The second alternative is supervision using existing regulations. MFIs are encouraged to register as formal financial institutions under a country's existing banking and financial services legislation. This option saves the need to establish a new regulatory framework, and to train staff to deal with MFIs as distinct financial institutions.

The provisions of the BFSA (Banking and Financial Services Act 1994 (as amended)) and Regulations governing banks and NBFIs in Zambia as currently operating do not encourage MFIs to seek registration with the Bank of Zambia. For example, the Act restricts ownership of a bank or NBFI to 25 per cent of the minimum capital for setting up a small credit financial institution. Capital requirements are significant. In addition, regulatory reporting requirements are comprehensive and do not focus on the special circumstances of MFIs. Because of these difficulties, only two MFIs are currently registered.

Increasingly, countries around the world are opting for the third alternative of establishing special regulations to provide for the specific characteristics of MFIs. The new regulations set entry standards and authorisation levels for the provision of different services that are commensurate with the demonstrated institutional and capital capacity of MFIs, and with the applicant organisation's capital at risk. The exact details of the legislation and regulation are dependent on the individual country's approach to financial sector development.

The advantage with special regulations is that they permit MFIs to maintain their distinct characteristics without becoming a bank or a large NBFI in exchange for a lower capital requirement. This approach accommodates a more varied range of financial institutions, encouraging innovation, which adds depth to the financial system without weakening it.

Which MFIs should be regulated?

One regulatory agency is unlikely to have both human and financial resources to regulate and prudentially supervise every single MFI operating within a country. Additionally, the risks of systemic or sectoral failure are not best managed by such heavy supervision. Accordingly, a mechanism of tiered regulation and supervision may be most appropriate. In Zambia we refer to the development of appropriate subgroup supervision as 'light touch regulation'.

The literature weighs heavily in favour of only regulating MFIs that accept deposits from the public. Deposit-taking MFIs have the potential of presenting regulators with systemic problems in case of financial distress. MFIs that only provide credit have very little impact on regulatory issues pertaining to the protection of the financial system, protecting small depositors and managing money supply (Maimbo 2000).

However, both Meagher and Wilkinson (2000) and Maimbo (2000) observe that, although the failure of one MFI is unlikely to bring down the entire financial system, it is possible that confidence within the microfinance subsystem would be adversely affected by the failure of a larger MFI. The failure of one MFI is likely to have an impact on the depositors' willingness to entrust their small funds with other MFIs, and the failure of a credit-only MFI can cause 'unzipping' or repayment failure in other MFIs. This argues for consideration of either prudential or non-prudential supervision of the largest credit MFIs.

Maimbo (2000) and discussions in international e-mail groups, such as the Development Finance Network, indicate that it is useful to make a distinction between 'prudential regulation' and 'non-prudential regulation'. Non-prudential requirements refer to those legal responsibilities and duties that do not involve the regulatory authority assuming responsibility for the soundness of the 'regulated' financial institutions. These requirements may include the registration of licensed entities, disclosure of ownership and control structures, reporting or publication of financial statements, external audits, and the transparent disclosure of interest rates to customers. These requirements do not attract any accountability (explicit or implicit) for depositors' losses in the event of failure.

'Prudential regulation', on the other hand, involves the definition of detailed standards for financial structure, accounting policies and management practices. Enforcing prudential regulations requires much more intensive reporting as well as on site inspections. There are suggestions that non-prudential regulation can be applied to all MFIs, while prudential regulation is restricted to deposit-taking institutions and potentially the largest credit MFIs.

Should MFIs be allowed to accept deposits from the public?

MFIs are keen to accept deposits in order to achieve self-sustainability and autonomy from donor financiers at a more rapid rate. Public deposit mobilisation provides them with a source of funds for on-lending. Hence, savings services are as important to microenterprises as are credit facilities. They are particularly important for the viability of the MFI serving microenterprises. Additionally, work such as Hickson's (1999) shows that the poorest households are far more in need of savings services than loan services.

Prior to BFSA amendments, the taking of deposits from the public was restricted to commercial banks. However, mobilising savings from members is permissible under the Cooperatives Act, the Building Societies Act, the National Savings and Credit Bank Act, and the Co-operative Bank Act. Regulations on MFIs will need to be specific to address this issue explicitly.

MFIs that may be permitted to accept deposits from members of the public should be subject to prudential requirements or have significant restrictions on how the deposits are held. For example, in Mozambique, MFIs hold all savings in commercial banks, adding a level of security to the funds. However, MFIs that accept funds as a partial guarantee of loans, and safeguard those funds held in excess of client loan balances, may not need to be prudentially supervised.

What services should be allowed under microfinance licences?

Currently, the focus of MFIs is on the delivery of credit services. Savings, called by Dale Adams of Ohio State University the 'forgotten half' of rural finance, is added later or considered in the context of membership, as with savings and credit groups and credit unions. However, recently MFIs have been introducing insurance services, and in some countries foreign exchange services and transfer services are offered. The relative public benefits and supervisory costs must be considered when determining what services should be allowed under MFI licences. Tiering provides a convenient mechanism for dealing with this issue. As MFIs become larger and wish to provide more sophisticated financial services, they in turn become more able to provide information and reporting consistent with a deeper supervision engagement.

What mechanisms should be used to graduate MFIs?

If the graduation process from NGO to more formal ownership and expanded service provision is to be encouraged, regulators need to establish criteria by which it is to be regulated and to understand the conditions under which it can be successful. The process requires the existence of certain market conditions: interest rate liberalisation, the elimination of barriers to entry, and the establishment of adequate supervisory and regulatory agencies and rules. Fortunately, these preconditions already exist in Zambia.

The process of graduation to taking deposits attracted some risks. For the MFIs, there is the risk of failing to comply with the loans provisioning and reporting requirements imposed by regulators. For the regulator, there is the risk of granting a licence before licensees are adequately prepared to operate as deposit-taking financial institutions. Regulating and supervising such institutions requires additional resources.

Meagher and Mwiinga (1999) have suggested tiering regulation and supervision, to enable MFIs to grow into both reporting and provision of other services. This suggestion, along with that of De Gruening et al. (1998), will be carefully considered as options for the Zambian microfinance sector.

Who should bear the cost of regulating and supervising MFIs?

MFIs have a smaller asset base, a larger number of accounts, a high degree of decentralisation, and a long period to reach financial self-sufficiency. They are generally more labour intensive in terms of inspection requirements, and their capacity for accurate, timely, useful financial reporting is more limited than that of other financial institutions. Thus, supervision costs can be expected to be relatively high. Because it is harder to pass on high supervision costs to MFIs and their clients, regulators are generally reluctant to accept additional responsibility for MFIs. For this reason, tiering and potential supervision surcharges to clients as the natural beneficiaries of supervision should be considered.

What are regulatory and supervisory best practices in microfinance?

Overall, the literature on microfinance is yet to develop international standards or principles of best practice in regulation and supervision. Meanwhile, other issues not discussed here are already influencing industry supervision: the setting up of apex institutions and their internal push for self-regulation, the use of rating agencies to evaluate loan applicants, and the creation of deposit insurance schemes. Unlike for commercial banking, there is insufficient experience with MFI regulation and supervision to enable certainty on governance principles.

It is important, therefore, that new regulatory frameworks developed in countries with an emerging microfinance industry take into account the specific institutional environment. The regulatory method adopted must promote a competitive balance among all financial institutions in the country. It must be flexible enough to accommodate different financial institutions and to facilitate their growth and financial sustainability. It is important that an excessive level of prudential regulatory requirements is not imposed on emerging microfinance sectors. A regulatory structure that is too detailed in its prescription of prudential requirements may stifle, rather than promote, the growth of the industry.

Conclusion: Achievements and challenges

MFIs promise to be a fundamental delivery vehicle of financial services to the poor. In Zambia, the opportunity to organise this sector cannot have come at a better time. The initiative has commenced to develop a regulatory and supervisory framework, but it should be accelerated to capitalise on the goodwill exhibited by donors, various government agencies and the players themselves.

Progress in sector governance has so far been limited to passage of the amendment to the BFSA to provide for the development of MFI regulation and supervision. This achievement was a result of close collaboration with stakeholders.

The Bank of Zambia has indicated that it seeks to apply a 'light touch' regulatory and supervisory framework that will nurture rather than impede MFI growth. The challenge to be a front-runner in Africa to develop best practice for legal, institutional and regulatory systems for microfinance will be embraced wholeheartedly.

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Note

1. This section draws from Maimbo (2000) and numerous in-house discussions, as well as from Rosenberg and Christen (2000) and Meagher and Wilkinson (2000).

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Developing savings facilities: The Opportunity Microfinance Bank in the Philippines

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Introduction

While the Philippines government and microfinance NGOs have made significant efforts to supply credit and savings facilities to poor households, the structures they relied on often failed to reach significant numbers because they remained outside traditional capital markets. In 1999, only 23 per cent of the 961,127 Filipino families dependent upon their small businesses for their livelihoods were able to access some form of credit (Opportunity International 2001). And while most poor households lack viable credit options, even more lack access to formal savings mechanisms that would allow them to build up a stock of financial capital over time.

Microfinance practices worldwide tend to focus on credit delivery, though this is changing. The low level of savings mobilisation by microfinance institutions (MFIs) is attributable, in part, to their origins as NGOs, beginning as channels for external funds from governments and/or donors. For some MFIs, the dependence on such funds is increasingly an obstacle to growth based on savings mobilisation. At the same time, other MFIs have proven that microfinance can be profitable and independent of reliance on access to donor funds for growth. This finding has led microfinance practitioners to consider options for commercialisation,[1] including transformation from donor-driven credit-only institutions into formal financial intermediaries with a strong base of small deposits (Campion and White 1999, Otero and Rhyne 1992, Remenyi and Quinnones 2000).[2]

In August 2001 the Opportunity International Network established a national thrift bank – the Opportunity Microfinance Bank (OMB) – to provide credit, deposit and value-based auxiliary financial services to the entrepreneurial poor in the Philippines. It is the first such bank to be approved and launched in that country.

The foundations of OMB go back to 1981 when Opportunity International and its network of Philippines affiliates, the Alliance of Philippines Partners in Enterprise Development (APPEND), commenced microenterprise development (MED) programmes in Manila. Over the following 20 years, the APPEND network grew to include nine affiliated organisations, managing US$9 million in loan funds and serving over 108,000 clients with loans. In December 2000, five partners[3] committed to transition to a single microfinance bank whose licence was granted by Banko Sentral ng Philipinas (BSP) in May 2001.[4] The bank's principal aims are to become a vehicle for mobilising resources within the community in the form of formal savings, to reduce finance and operating costs and to increase client outreach through additional leverage. Through this formal banking structure, the OMB is expected to generate an outreach of 100,000 borrowers/depositors by 2004.[5]

The demand for microsavings facilities

The large demand from the poor for savings schemes is well documented (Hannig 1999, Rutherford 2000). The savings motives of poor households are varied (Robinson 1994). Some include evening out income streams that are subject to seasonal variations. Savings can also serve as insurance substitutes in case of bad health, disability, sudden income losses and retirement. Furthermore, they can help a household to achieve long-term goals, such as social and religious obligations, or facilitate future investment and consumption. Other motives include the possibility of locking funds away from relatives and friends, the divisibility of formal savings, and the option of gaining access to other financial services or strengthening social relations.

The low level of savings among poor households is mostly attributable to inappropriate deposit facilities and institutional structures that force the poor to rely upon in-kind savings, such as gold, animals or raw materials, or upon informal intermediaries such as revolving savings and credit associations or money-keepers (De Soto 2000, Remenyi 1991, Robinson 1994). These informal options, however, do not offer the combination of security of funds, ready access or liquidity, positive real return and convenience that really meets their various needs.

Rationale for savings mobilisation from an MFI perspective

The central obstacle in the provision of full-fledged financial services to the poor is reconciling outreach and sustainability. Outreach is the extent to which financial systems and their instruments reach the poor directly. With the creation of demand-driven deposit facilities, many microfinance programmes could attain a breadth and depth of outreach as well as a level of impact that credit-only programmes cannot achieve. Savings-based schemes are likely to be more empowering for the poor than credit-based ones: most people want to save most of the time, while they do not want to borrow all the time. Moreover, successful deposit-taking institutions that also lend to the poor tend to have many more depositors than borrowers. Savings schemes also contribute to programme growth. Growth in the form of the addition of new and better products, such as deposit facilities, helps the intermediary satisfy more of the demands for financial services from existing and potential clientele. This improves the quality of outreach and enhances the image of the MFI (Gonzales-Vega 1997).

Sustainability is a necessary condition to achieve outreach and programmme growth (Gonzales-Vega 1997). Sustainable growth is a signal to the intermediary's potential borrowers and potential lenders about the programme's strength and purpose. It serves to attract loanable funds for additional growth and also contributes to an increase in customers' willingness to repay loans. Sustainability has been absent from many officially sponsored development assistance projects for providing credit to poor people during the past 35 years (Zander 1997). Hannig (1999) argued that if long-term sustainability is the ultimate goal, fully-fledged financial services must be provided to poor clients. In fact, few MFIs that do not mobilise savings have attained full financial self-sufficiency (Remenyi and Quinnones 2000).

Savings mobilisation is certainly an important step towards MFI commercial viability.[6] It contributes to the attainment of viability by reducing dependency on external borrowings for growth in outreach capacity. Savings represent a stable, and cheaper, source of funds and allow an institution to engage in community-based finance as opposed to finance that may be subject to the priorities of governments or donors. Deposit taking also provides incentives to improve governance and cost efficiency. If MFIs do not offer financial services efficiently or tarnish their reputation as trustworthy financial intermediaries, depositors have at their disposal a strong retaliation device: the withdrawal of deposits. Furthermore, savings deposits enable deposit-takers to have a window on depositors' savings capacity, which is a good basis for determining their debt capacity (Remenyi 1991). Finally, depositors have to have a certain degree of confidence in their financial institution, which also gives them incentives to behave responsibly as borrowers.

Preconditions for a successful savings programme

Apart from the developmental impact the creation of savings facilities can have on OMB's targeted clients, the fundamental reason for setting up the bank was that access to capital markets would provide increased access to cheaper capital, and more opportunities to leverage other sources of growth and resources for greater outreach. Two key sources of new capital under the OMB model are savings deposits[7] and rediscounting.[8] Previously the partners collected mandatory savings from loan clients. However, as this was legally considered to be loan collateral rather than actual savings, those savings products were not truly responsive to the clients' differing needs. In addition, the organisations could not use the savings as loan portfolio to assist in their scale-up efforts.

Although it is still early days, OMB provides some useful insights into the most appropriate preconditions for establishing successful savings facilities, including: industry experience, knowledge of the community, a proven growth model, the systems to make national scope achievable, and an ownership structure acceptable all members.

Industry experience is most important. Credit-disbursing institutions must first prove their accountability and the soundness of their operations because accumulated expertise is the best protection against failure.

An in-depth *knowledge of the community* and a good reputation within this community are essential, as the MFI must build the confidence of clients in order to compete with informal and in-kind savings options. This knowledge is also indispensable to appropriate client profiling and product design. Profiling becomes more complicated where a microfinance bank services not just microentrepreneurs but a cross-section of the community. Geographical, social and cultural proximity is critical: not only does it lead to effective customer orientation, but also close contact with clients helps to provide peer pressure, reciprocity and a common value system.

Demand-oriented savings products are essential to attract significant volumes of savings (Elser et al. 1999, Fiebig et al. 1999). Given the variety of savings motives, the demand for deposit schemes is best met with a mix of savings products offering different levels of liquidity and returns. Poor savers prefer voluntary savings products (Hannig 1999). They mainly demand safe and liquid assets. They also need savings services that allow them to deposit small variable amounts frequently and to access large sums in the short, medium and long term (Rutherford 2000). Finally, small depositors value convenient delivery systems.

The experience of APPEND and Opportunity International in the Philippines over so many years has strengthened their reputation in the community. Also, many OMB clients already held mandatory savings accounts with the local agency along with their loan – the so-called capital build-up accounts – and these forced savings permitted the partners to gain savings expertise. This has enabled OMB to adequately respond to client needs.

Savings services are oriented towards two products: one for borrower-savers and another for voluntary savers. In the first case, loan officers are the vehicles for providing savings facilities to current borrowers and savings are collected at group centre meetings. In contrast, voluntary deposits are largely made by walk-in clients and processed by tellers located at the bank branch, in the local community. To offset the high transaction cost of offering microsavings deposit services, the bank is also able to offer certificates of deposit to local corporations and organisations. The OMB also aims to introduce special savings accounts for poor entrepreneurs (that is, with a minimum balance of under 100,000 pesos). This product should meet the needs of another section of the market: savers who want semi-liquid time deposits. It would be particularly useful for poor families wanting to save for religious and social events and for education costs that come up at certain times of the year. Furthermore, as the branches of APPEND partners that are transitioning into branches of the OMB were already located in areas characterised by severe poverty and high levels of microentrepreneurship, the current OMB branches are very accessible to the targeted population.

The use of a *standardised branching methodology* proved necessary for the successful transformation to a formal financial institution as well as for future national expansion. Sustaining expansion certainly requires a *solid growth model* and the systems to both manage and integrate operations dispersed throughout the Philippines. The branching methodology is a decentralised operating unit building on a core group lending system to achieve rapid outreach and profitability. The methodology was developed, piloted and refined over three years within the NGO context. This model ensures a focus on addressing the target group level of poverty and generates the appropriate and timely information required to ensure maximum portfolio quality.

To manage portfolio growth, Opportunity International has partnered with Temenos, a division of Globus. The Temenos eMerge™ platform provides an information technology solution designed for microfinance, supplying the OMB with the facilities to relate to and comply with evolving national banking industry regulations. Temenos eMerge™ is one of a few platforms with the capacity to serve both the microfinance and the banking industries. It links the bank head office with all collection and disbursement points (CDP) and bank branches, while providing for a broad range of credit products, deposit products, and auxiliary banking services.

Given that investing MFI-NGO boards are not primarily motivated by economic gain, the initial commitment to transition to a common thrift bank structure required *shared vision and values*. Only an ownership structure that adequately protects those values in the long term could take the bank forward. Each local partner investing in the bank has developed a track record in the community that makes local ownership both relevant and desirable. The former MFI-NGOs have to decide: whether they will serve on the boards of directors; the appropriate level of outside investment; and to recruit new management and outside board members.

For OMB, the BSP licensing requirements associated with establishing new branches limits the investing MFI-NGOs' ability to transfer their clients to the bank at will. Investing They cannot increase their ownership in the bank until the branch or CDP is licensed and their outstanding client loans are paid back. The impact of this is that the number of additional common voting shares held by the local investors becomes a moving target until BSP provides better indications of the integration time frame it is planning.

In light of this, the commitment is to ensure that the local Opportunity International affiliates in the Philippines, including the APPEND Network office, have at least a 50 per cent ownership. The Opportunity International Network, as the foreign investor, will participate with a 20–30 per cent ownership, while the remaining participation will include other like-minded investors. This provides sufficient scope for PHP 200–300 million in voting common shares for the first phase of expansion. Subsequent capitalisation will take the form of non-voting preferred shares. Preferred shares are chosen as a means to finance future expansion without compromising commitments to maintain local ownership in the long term.

The MFI interested in offering savings facilities must also consider the issues of: legal structure, trust, endorsement, deposit insurance, accountability, and risk and liquidity management.

The *institutional and regulatory framework* has to be considered. Government interventions may seriously restrict credit operations and deposit mobilisation. Furthermore, a key consideration as to when to introduce voluntary savings and protecting clients' interests is the existence of appropriate government supervision (CGAP 1997). For OMB, it was essential that the Philippines Government modified its banking supervision regulation so that it would be in a position to monitor savings schemes effectively, which it did in January 2001.

Building *trust* is imperative. The security of savings and trust in the savings repository are critical in influencing poor households to hold a savings account (CGAP 1998). Trust can be built on the reputation of loan products and by making the programme accessible with branches in target communities and by employing professional field staff. With regard to field staff, banking skills are not essential. Rather, the mobilisation of microsavings requires establishing a close and trusting relationship with microclients, which is easier when staff are familiar with local languages, customs and norms.

Endorsement will help with building trust. The OMB was launched by President Gloria Macapagal Arroyo during her regular weekly press conference and covered by national and international media. Officials from the Central Bank and the Monetary Board also attended. Former president Fidel Ramos and his daughter Angel have been made patrons of the OMB.

Deposit insurance is also considered to be extremely important in inspiring confidence in the newly formed financial institution. The OMB has insured deposits with the Philippines Deposit and Insurance Corp. With regard to *accountability*, the OMB relies on internal audits as well as network standards and accreditation.

Savings mobilisation requires sophisticated *risk and liquidity management* capabilities. Risk management measures contribute to the safety of deposits and strengthen depositors' confidence in the bank. As the loan portfolio constitutes the largest part of risk-weighted assets, the quality of lending operations is decisive for the safety of deposits. The challenges of liquidity management are numerous: MFIs that wish to offer savings facilities not only need to manage funds provided by government or donors for the credit operations, they also need to transform maturities, volume and risk. Finally, although case studies show that small deposits provide a relatively stable core of funds (Hannig 1999), savings schemes must be able to cope with sudden change in depositors' liquidity requirements and frequent withdrawals. Thus, in addition to sophisticated liquidity management capabilities, the bank needs safe and liquid investment options to cope with changes in depositors' behaviour without having to hold large amounts of cash as non-earning assets. Highly trained and motivated staff and appropriate monitoring and accounting systems contribute to valid risk and liquidity management. The OMB had to recruit specialists to the team in order to develop products and manage their implementation, as this experience was lacking in the former NGO staff that transitioned to the bank.

Conclusion

The OMB' s application has been fast-tracked and approved by the BSP largely because it has the correct legal structure built on the appropriate foundations required for national expansion. In addition to strong industry and community knowledge, the OMB has the growth model, systems and ownership structure that position it well for a competitive future. While the OMB is just beginning its journey as the first microfinance thrift bank serving the poor in the Philippines, this early experience should provide useful guidelines for other NGOs aiming to transition into formal financial institutions.

Notes

1. The commercialisation of microfinance can be considered any one or a combination of the following: progression towards operational and financial self-sufficiency, adoption of for-profit orientation in administration and operation, and utilisation of market-based sources of funds that entails being subject to banking regulation and supervision. According to Otero (2000), the transformation of NGOs into regulated commercial institutions marks the second phase of the commercialisation of microfinance. The third phase will begin when microfinance attracts a significant number of private investors, whose investments are motivated by the MFI's profit potential to become shareholders of commercial MFI. The first phase was marked by the adoption of commercial principles of operation.
2. Formal financial institutions are subject not only to general laws and regulations but also to specific banking regulation and supervision (Ledgerwood 1999).
3. Lead investors in the bank are all members of the Opportunity International Network: five are MFIs organised as NGOs and MFI-NGOs operating in Luzon, Visayas and Mindanao, Philippines; and the remainder include APPEND, Opportunity International United States, and Opportunity International Australia.
4. The BSP had imposed a moratorium on new banks and limited expansion of new branches in the aftermath of the 1997 Asian financial crisis. However, since January 2001 it has approved guidelines for microfinance banks.
5. Strategies for establishing deposit-taking MED vary from credit-first to saving-first sequencing. Approaches include the establishment of new institutions as well as the down- and up-scaling of existing financial institutions. The OMB provides an empirical insight into the credit-first sequencing and up-scaling approach.
6. Schmidt and Zeitinger (1996), in contrast, argued that collecting small deposits entails high administrative costs that will turn it into an unprofitable business for MED.
7. As the MFI-NGO branches transition to the bank, clients gain access to an expanded range of services including the opportunity to open passbook savings deposit accounts. Mobilising public deposits is part of the package of full financial services offered by the bank to its customers.
8. With time the bank will be able to rediscount its receivables. While access of the rediscount window for unsecured microfinance loans was not projected to take place for several years, recently released guidelines provided by BSP bring capital markets and opportunities to expand using those capital markets closer to reality. Leverage for MFI-NGOs had been limited to four times their equity. Based on capital adequacy and risk asset ratio requirements under the bank, this leverage may increase to up to six times equity. The financial model provides the scope to double the leverage and impact, while over time reducing the cost of capital through rediscounting and an expanding depositor base.

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Microfinance and women's empowerment: Turning lead to gold?

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> *That is why alchemy exists. So that everyone will search for his treasure, find it, and then want to be better than he was in his former life. That's what alchemists do. They show that, when we strive to become better than we are, everything around us becomes better, too. (*The Alchemist*, Paulo Coelho)*

Introduction

This article endeavours to clarify the link between women's empowerment and their access to microfinance services. This is important, for microfinance programmes are widely seen as appropriate not only for alleviating poverty but also for positively influencing gender issues in development. There is also a need to discover the extent to which microfinance is able to strengthen women's social and economic worth and to draw some lessons on that basis. This article reflects on the experience of Kashf Foundation, which began in 1996 in Pakistan as a Grameen Bank replication (see www.kashf.com), as an experiment to provide financial services to women from low-income communities.

What is empowerment?

Stated simply, lasting empowerment for women is based on: (i) an improvement in their bargaining position, both within and outside the family; (ii) a visible foundation of economic and social gain; and (iii) a process that mainstreams their participation at institutional and policy levels. Empowerment involves change at three broad levels: within the household, within the community, and at a broader institutional or policy-making level. However, empowerment must also involve a transformation in how women define themselves in the context of an evolving society. It can be seen as a process through which they are able to transform their self-perceptions – equivalent to an alchemy of visibly transforming gender roles.

The feminisation of poverty

To establish the link between microfinance and women's empowerment, it is necessary to determine how poverty impacts on women's lives. The following statistics from Kashf (2001) illustrate the female face of poverty:

- The household budget of a poor family in Pakistan (one earning less than a $A1 a day) is spent on the following: 55 per cent on food, 25 per cent on rent and utilities, 12 per cent on some form of savings, and less than 8 per cent for investing in human capital.
- Over 76 per cent of women in low-income communities are illiterate; only 24 per cent have completed less than five years of formal schooling.
- The majority of the women and their families have poor diets, and cannot afford luxuries like meat more than twice in a month.
- Most women suffer from regular, minor illnesses which take their toll on the household economy and the well-being of the family. In terms of spending money on their health, women usually prefer to access the local faith healer rather than a 'Western' doctor or hospital. On average, they visit a 'health care' practitioner at least six times a year, irrespective of their age.
- Almost half of the women have lost a child of under two years of age, an incidence which has far-reaching traumatic implications for their mental and emotional health.
- Most households live in highly congested one-room houses, with an average family size of seven members.

The above statistics reveal that the realities of poverty in terms of human capital generation are quite stark. The strains on the household budget lead to a de-prioritisation of longer-term investments like education and health. A combination of the above factors generates low self-worth and self-abnegation by women of their basic rights, and so the vicious cycle continues. Direct investment in children's education, combined with better access to health care, can radically improve the social status of women and can, to a certain degree, pull back the curtains of squalor that constrain the potential of women in traditional societies.

Microfinance and the value and risk frontier

Life in the context of poverty is fraught with a great deal of uncertainty. This emanates from both the uncertainty of the economic opportunities facing the households, what can be termed as 'economic risk', to the basic risk of managing life itself, that is the 'death risk' or the 'health risks'. Microfinance attempts to reduce the financial vulnerabilities faced by poor households by providing

Table 1 Kashf's microfinance approach

Empowerment indicator	*Programme strategy*
To be successful, empowerment must lead to economic gains for women and should also enhance their role in economic decision making.	The Kashf approach includes the provision of pro-poor loans and savings services that particularly cater to the needs of poor women. These include two basic lending products, the general loan and the consumption loan, along with a flexible, open access savings product. Kashf also offers a life insurance product for its customers to manage life risks.
To be successful, empowerment must lead to greater leveraging and networking among women in the community.	The Kashf concept relies heavily on building dynamic centres, each comprising 25 women. These centres then become the window of opportunity through which Kashf's social transformation training courses on leadership, gender and reproductive health are offered. Kashf also propagates social themes and offers women the opportunity to evolve individual social contracts.
To be successful, empowerment must provide a gender-sensitive and proactive institutional framework for women.	Kashf delivers microfinance to women by women. This creates an opportunity for role modelling at all levels of the institution and also caters to the specific needs of women in microfinance and beyond.

access to loans that can be invested in existing or new economic opportunities or used for consumption to meet small-time contingencies or longer-term life-cycle needs. At the same time, access to micro-savings also initiates a new horizon for poor households, especially when savings are convenient, accessible and secure. Poor households can either save through their crises or take loans to manage cashflow needs. Within this financial frontier, microinsurance has also emerged as a major opportunity for influencing, in particular, the death risk/health risk confronted by households.

However, the above framework does not seem to carry much weight as far as the deepening feminisation of poverty is concerned. It looks at risks that affect men, women and children across the board. So what is the alchemist's elixir that places microfinance in the unique position as a development strategy to impact positively on the three basic indicators of empowerment: social and economic gain, bargaining position, and institutional visibility?

Microfinance operates on the value and risk frontier; in other words, financial services must generate value for the client and the institution and, at the same time, mitigate risk for both parties. The binding force between the two is the service delivery methodology utilised to contain risk and impart value, along with the principle of basing success on the individual entrepreneurial spirit of poor households. In the context of the microfinance paradigm in South Asia, some form of 'group' or social collateral mechanism has been put into place and it is this particular glue that generates social capital and mitigates individual risk. Groups set up for credit and savings become a window of opportunity for positively influencing women's social status.

Microfinance is built on the basic drive by humans to improve their lot and that of their families. In this context, each man or woman can be an alchemist in his or her own environment. Microfinance is a vehicle for enhancing women's existing opportunities and their inherent capacities to view the economic progress of the household holistically. Men and women are rational economic agents who can promote the well-being of their families jointly. Table 1, which places Kashf's microfinance approach against the basic empowerment profile, can perhaps illustrate this point of view.

Myths about women's 'lack of empowerment'

However, at the same time, researchers, intellectuals, writers and microfinance practitioners sometimes fall into the trap of making assumptions about women's role and their degree of disempowerment. Following are examples that break some myths about women's social and economic role and further strengthen the contention that microfinance builds on the inherent strengths of women:

- That, in a rural and also an urban setting, there is a women's space (the domestic arena) and a male space (the public arena) and that gender relations are boxed into these spatial realities.

It is important to hold this myth up to the litmus test of field reality. There are many instances where women are transacting businesses and have been successful micro-managers, even when faced with many economic and social hurdles. There are hundreds of examples of women as active commodity traders, shopkeepers and economic arbitrators. The ubiquitous female shopkeeper in a majority of South Asian villages is perhaps the best example.

- That women's mobility is constrained and women are restricted to pursuing economic opportunities within their direct households or communities.

This restriction, especially in an Islamic setting, is considered to be foreboding and paralysing for women entrepreneurs. However, there are many cases where women have been able to cast away the shackles of mobility and travel regularly to bordering countries like Afghanistan or India to purchase tradeable items like cloth, costume jewelry and tinsels. Some women are pushing into previously male-dominated professions like taxi driving and public transport.

- That women can undertake only home-based traditional activities and do not innovate with new options.

The types and the nature of businesses that women undertake are vast and they need to be recognised for these innovations. Businesses vary from low value added agro-activities to high value added manufacturing. Some are even as sophisticated as manufacturing spare parts for three-wheelers (rickshaws). Within the microfinance industry there has to be greater recognition and respect for the initiative and enterprising mindset of female entrepreneurs. One interesting case is that of the video woman in a community outside Lahore, who rents out her VCR to male groups every evening for Rs150, with an immediate down payment.

- That women are not involved in financial decision making in the household.

There is ample research which highlights that, even in the most traditional societies, it is the thriftiness of women that enables households to manage contingencies. In participatory rankings with female groups done by Kashf (1999), it was discovered that 63–67 per cent of the women participated actively in savings and spending decisions in their households. A similar conclusion can be drawn from another study (Kashf 2000), in which over 83 per cent of the women stated that they were involved in household decision making.

The test of the alchemist: Impact of microfinance on women

The following outcomes are taken from two assessments of Kashf's ongoing microfinance programme, and highlight the economic and social impact of the programme on women and their families. Broadly speaking there are three indicators that are important for observing and assessing trends in the link between microfinance and women's empowerment:

- the ability of the programme to generate enhanced trust, solidarity and social interaction;
- the impact of microfinance on women's self-confidence and self-esteem; and
- the opportunities created by the microfinance programme for leveraging and networking.

Conclusion

The table highlights the fact that the impact of microfinance is much stronger with respect to the individual and her self-worth than in other respects. There can also be a change in inter-spousal parameters, which further improves the way women perceive their role and their relationships. At the community level, the group becomes a facilitating process for managing economic and social concerns.

Table 2 Assessments of the Kashf microfinance programme

Empowerment indicator	*Results of impact assessment (Kashf 1999)*	*Results of social intermediation study (Kashf 2000)*
Enhanced trust, solidarity and social interaction	Social Interaction: 90% meet their centre and group members outside meeting dates. Role of Group/Centre: 35% turn to their group for support in times of financial difficulty. 42% actively view the group and centre as a support mechanism, while 31% view it as a support to meet instalments.	Social Interaction: 71% meet their centre and group members outside of centre meetings; 69% value the associations created in the group. Role of Group/Centre: 57% turn to their group at times of financial need. During social interaction with groups, women are able to share loan issues (44%) and life-cycle events (22%) and go together to the market (20%).
Increased self-confidence and self-esteem	48% felt their self-confidence had increased since they could plan for a better future. Other observations: reduced dependency on moneylenders, enhanced sense of self-pride since they were able to meet their financial obligations. 40% also felt self-confidence had increased because there were less domestic fights over income, while 10% stated their families respected them more; 23% felt there was no change in their families perceptions; 62% felt that their self-confidence had increased. 77% indicated there had been little programme impact with respect to community perceptions. This could be an indicator of the fact that social and communal change requires longer-term interaction. Gains in self-confidence are higher where women have utilised the loans themselves.	54% indicated that their spousal relationships had improved following Kashf membership and that their husbands respected them more; 38% stated there was no change in the way their husbands treated them Gains in self-confidence are higher where women have utilised the loans themselves.
Leveraging and networking	Attitudinal Changes: 42% would like to pursue a different future for their daughters, while 52% wanted to educate their daughters. This highlights the role modelling aspect of Kashf's female staff.	Attitudinal Changes: There was perceived to be a gradual shift in women's perceptions about the roles of their daughters; 35% see the loan officer as role model. An overwhelming percentage considered Kashf to be their organisation, one they could influence.

Local elections were held all over Pakistan in the summer of 2001. Fifteen Kashf clients stood for elected positions, and nine of them won their contests. Soon after the elections they were interviewed by Kashf staff. One, Nasreen Baji, echoed a common assessment when she said, 'Kashf helped me in getting here. Kashf teaches us the way to win, to be confident, to rely on ourselves as being capable of doing anything. From gaining confidence to getting to know people, Kashf has played a big role in my success!' As a Grameen Bank replication, Kashf is pleased to stand in the reflected pride of its clients in their success.

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Grameen Bank-style microcredit: Impact on dowry and women's solidarity

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Introduction

The most significant single development since the late 1980s through 1990s in relation to Bangladeshi rural women has been the growth of microcredit or [1] microfinance schemes aimed at them, an approach pioneered by Grameen Bank, an institution which lends primarily to poor village women. Most major NGOs operating in Bangladesh now have similar programmes, and they have also been imitated in many other countries.

In this article, 'GB-style microcredit' is used as shorthand to refer to the specific model introduced by Grameen Bank. This form of microcredit is heavily 'top down'. The women themselves have little or no say in the organisation, though they are compelled to attend regular meetings. Loan decisions are made by a bureaucratic organisation and rigid repayment schedules are imposed by its officials, for the most part irrespective of a woman's ability to meet the repayments.

It should be emphasised that there are many other forms of microfinance organisation, including the ROSCAs (Rotating Savings and Credit Associations) and credit unions which have long existed among poor populations around the world. These organisations, often much smaller in scale, can be far more 'bottom up' and essentially controlled by their members as a whole. It is the GB-style microcredit, however, that was endorsed on a large scale by the international development community in the late 1990s and which is the subject of discussion here.

In the mid-1990s, the Grameen Bank style was hailed internationally as a radically new approach with the potential to bring about spectacular improvements in the living standards of the poorest sectors of the world's population or even to end world poverty altogether. Grameen Bank was particularly popular with the Clinton administration, and a major Microcredit Summit was held in Washington, DC, in 1997. Numerous books and papers appeared describing Grameen Bank in the most glowing and positive terms, and its focus on lending to poor women in village communities was seen as a particularly significant and praiseworthy innovation.

In retrospect, while microcredit schemes are continuing to grow in Bangladesh and elsewhere, the Washington Summit was perhaps the high-water mark of the GB style. By the late 1990s, more realistic reports were beginning to show the limitations of the approach. While GB-style organisations have had real benefits for some rural women, which have been well documented, this approach to microcredit also has major problems (see Goetz and Gupta 1996, Kabeer 1998, Lingle 2001, Montgomery 1996, Neff 1996, Rogaly 1996, Teare 1996; see also Rozario 2000 for a summary, and Zafar in this issue on the Kashf Foundation experience).

Critical discussions are now common, even in mainstream economic journals. Thus, Christopher Lingle (2001) has written that microfinancing 'is likely to yield only short-run benefits that will lead to long-run costs', describing it as 'a classic example of good intentions bringing about bad results'. Among these bad results are the forcing of many poor people into levels of debt they cannot afford to sustain, increasing workload, deteriorating diet, the disappearance of NGO programmes targeted at health, education and social security, the further marginalisation of the poorest of the poor (who do *not* receive microcredit, for reasons some of which will be explored here). In particular, GB-style microcredit does not confront the social, cultural and legal barriers that in practice keep the poor, and especially poor women, in their place.

This article focuses on two specific problems connected with GB-style microcredit in Bangladesh: its negative impact on women's solidarity, and its consequences for the practice of dowry payments. These problems are used to illustrate some more general points about the way in which GB-style microcredit fits in with the global programme of neoliberal economics and the incorporation of Third World societies into the capitalist economic system.

Impact on women's solidarity

One of the major selling points of GB-style microcredit has been that it is seen as contributing to women's empowerment through the targeting of loans to women. The reality, however, is that loans are mostly used by their husbands or other male relatives. This creates some difficulties for arguments about empowerment, although it has been argued plausibly that the individual woman's position within the family may be strengthened by her role in obtaining the loan (Goetz and Gupta 1996, Kabeer 1998, Rozario 2000).

But there is a more basic problem. Any acceptable definition of 'women's empowerment' must also encompass the aiding and promoting of solidarity among women. Yet GB-style microcredit, in a whole series of ways, works in precisely the opposite direction. It intensifies separation and competitiveness among women and destroys what solidarity may exist between them within the family and the village community. According to GB-style promoters, 'the ideal of peer groups based on social collateral implies that groups screen and self-select their own members to form relatively homogeneous groups' (Montgomery 1996:291). These groups are presented as contexts in which solidarity can grow between village women.

In reality, the situation is very different. The emphasis on repayment discipline means increased peer group pressure rather than mutual support. In my own research in a number of Bangladeshi communities where GB-style microcredit had been introduced, loan repayments were regular causes of conflict. In the words of a Grameen Bank officer, the main strategy adopted by bank workers in collecting weekly repayments is to 'keep the group under pressure . . . to threaten them that no new loan will be given to anyone in the group unless 100 per cent loan was collected'.

While, from the point of view of microcredit institutions, group collateral provides a way of making loans in the absence of any other collateral, a high price is being paid by women for it. Members resent defaulters, both because the entire group may be unable to obtain future loans and because everyone has to stay at the meeting until a missing payment has somehow been produced. Women in Bangladeshi villages do not have large amounts of time to spare on inessential activities and are in no position to stay around indefinitely. Under such pressure, they are prone to abuse the individual defaulter even more than they would do otherwise.

In addition, only a set number of loans can be issued each week. If there are more women than the loans available, the women often fight among themselves about who should be given the loan that week. Those who are due for their loan, but who are forced to wait until the last member has made her payment, are usually the most bitter. They become very aggressive and often incite others, such as the men, to go and get a piece of furniture or the corrugated tin roofing from the defaulting woman's house, or to take away a cow or other animal if she has one.

GB-style microcredit is also destructive to solidarity at another level, through the competition between microcredit organisations. Ever since most of the big NGOs in Bangladesh incorporated microcredit as their main activity, there has also been an emphasis on scaling up microcredit by expanding into new areas and also by recruiting new members for the *samities* (the local women's groups). There is no collaboration among these organisations regarding their provision of financial or other services for the villagers. Instead, there is an emphasis on people identifying themselves as BRAC (Bangladesh Rural Advancement Committee), Grameen Bank, Proshikha or ASA (Association for Social Advancement) members. During the local election of female members to the reserved positions of the Union Parishad (local council), the organisations played a central role by putting forward their own candidates and then campaigning in support of them.

While some former NGOs like ASA discarded all other development services and now deliver exclusively microcredit services, others such as BRAC continue to provide other services like health and legal aid, but essentially only to their own members. When their services are available to non-members, as happens in some cases with BRAC's health services, non-members are charged a higher fee. The joint ASK (Ain O Salish Kendra)-BRAC Legal Aid Outreach Programme, organised by the legal aid centre Ain O Salish Kendra in conjunction with BRAC, has had similar problems. While ASK would like the service to be available to non-members of BRAC, BRAC is interested only in helping its own members. Thus, villagers who do not join microcredit institutions, for example because they are too poor to maintain repayments, are disadvantaged not only in not having access to microcredit on flexible terms, but also through being denied other social development services.

In one of his speeches, Professor Yunus, the founder of Grameen Bank, describes it as a 'club' which will look after people from the time of joining. Even when members become financially self-supporting and prosperous, they can still maintain their membership[1]. A World Bank report gives a more critical perspective: 'Unless borrowers' graduation from low-level incomes to higher levels (if not from the programme entirely) is encouraged or achieved many members will become permanently dependent on Grameen Bank credit and services' (quoted in Neff 1996).

In practice, Grameen Bank and the various NGOs specialising in microfinance are competing to build up networks of clients who are indebted to them and dependent upon them. In a way, these networks reconstitute the old patron–client relationships of village politics on a much larger scale, and in a style more attuned to the neoliberal economic theory of the international financial establishment. Like the old networks, they cut directly across any development of 'solidarity' on the basis of class or common relations of exploitation. Thus, poor village families are becoming permanent clients of one or another organisation, while the poorest of the poor are excluded altogether. At the same time, other NGO approaches which have more potential for building up women's solidarity have been marginalised or closed down (Ebdon 1995).

Impact on dowry

After about 25 years of microcredit programmes in rural Bangladesh, ingrained gender values are still essentially unchanged. Those that contribute most in perpetuating women's subordination and which continue to hamper development efforts are *parda* (purdah) and *izzat* (honour), and the role of marriage in defining women's identity.

For a woman to move around freely remains unacceptable in Bangladeshi society. Entering defined male space poses a threat and challenge to men's honour and to the honour of the community. The hostility, sexual harassment and lack of cooperation displayed towards women who have taken up positions in local government are illustrative. The significance of *parda* and *izzat* for women's respectability, and thereby the honour of their families and communities, thus continues to stand in the way of their taking up non-traditional income-generating projects through microcredit loans.

For women, full adult status involves marriage. Unmarried women are not accepted in the microcredit *samities* and so cannot receive loans. The argument is that they will get married and go away to their husbands' village, then who will repay their loan? This denies any opportunity to marginal groups, like unmarried women and, of course, widows and abandoned women. Such policies also mean that unmarried women are made completely dependent financially on the mercy of their families (usually on male guardians).[2]

Even married women are not in practice treated as fully autonomous human beings, despite the prominence given in microcredit publicity to the fact that loans are given to women. Many microcredit organisations now require a man's signature (that is, that of the woman's husband or son, whoever is the earning member) before a loan can be sanctioned to a new member. When questioned about this development organisations responded that the reason was to make the menfolk who use the loan directly accountable for the loan. In other words, it is now being acknowledged that the loans are primarily used by men. A BRAC report has admitted this: 'The majority of women either depend on their male household members for utilization of their loan money or even hand over the loan to them for investment' (Husain 1998:177). Another reason given was that it ensured the identity of new members. A newly-married woman can only be identified in her husband's village through her husband. While the actions of the microcredit organisation may be dictated by their desire to secure repayment rather than by gender prejudice as such, the result is certainly regressive in terms of women's empowerment.

In the villages, an individual man routinely refers to the membership of his wife's *samity* as his own. Such direct identification is understandable because, while the wives are the official members, more often than not the men are the ones who utilise the loan and who are responsible for weekly repayment. However, it is also a reflection of the fact that, in the villages, it is taken for granted that women are nominal members; it is the men, the 'real' earning members, who count. So, it is not surprising that women routinely told me that they obtain loans if their menfolk tell them to, for whatever amount the men want; otherwise, they do not take out any loans. The GB ruling that, before a housing loan can be sanctioned, the land on which the house is to be built should be registered in the member's name has been presented as a way in which GB facilitates women's empowerment. Yet, in practice, it has more to do with protecting GB interests: in the event of failure to make repayments, the bank can take possession of the house.

The dowry issue demonstrates the superficiality of gestures made by microfinance institutions towards building women's solidarity or transforming oppressive gender relations. By and large, dowry remains unchallenged and is practised widely by all classes in rural and urban areas. Despite the prominence given to the elimination of dowry in the principles ritually recited at GB meetings, hardly any families refuse to accept payments at their sons' marriages, and none can afford to refuse to give dowry when their daughters marry. Dowry is also practised by the staff of microcredit organisations and this is usually not a secret.

It is important to note that women feel that the expected size of dowries has been increasing. The extra financial resources provided by microcredit have led to an escalation of dowry payments. Many women are actually using their access to credit to save for their daughters' dowries. Again, there is no secret about all this. In the two Dhaka villages where I conducted some long-term research, it was very common for GB members to regularly save Tk200–300 a month in bank accounts in the name of their very young daughters, aged three upwards. Indeed, when women were asked how they spent their microcredit loans, dowry was one of the most common consumption items on their list. Women would make jewelry for their daughters, to be given as dowry or used as cash for dowry items or for wedding feasts.

It is clear that women feel that there is nothing they can do to challenge the practice, although one or two said that they were able to marry their daughters to members of their own microcredit organisation from another village without dowry. Usually, however, while women might say that they should try to marry their children among their group in order to avoid dowry payments, this was not really being practised. The helplessness of women on this issue and their willingness to go to any length to ensure they can pay dowry for their daughters have to be understood in terms of the role of marriage in defining a woman's status.

Changing gender ideology is among the most difficult challenges for NGOs, microcredit organisations and government, precisely because it serves the interests of the dominant groups to maintain relations of domination in terms of class, religion and gender. It is in the interest of the middle class to continue to perpetuate various gender norms, including payment of dowry, as a way of distancing itself from the lower classes. Indeed, it has been observed by myself and others (for example, Kabeer 1998) that, once a relatively poor family improves its economic standing, it usually prevents its women from continuing outside paid employment so that they might be identified more as middle class. That dowry payments should have escalated when rural people have access to more cash through microcredit provision is perhaps not surprising in this context. While microcredit has not benefited the poorest of the poor and many other poor in rural communities, it has increased the consumption capacities of many poor and lower middle to middle class families, for example through improved housing and the ability to make higher dowry payments.

Certainly, if empowerment is taken to include challenging rural power structures and gender hierarchies, village women have not gained empowerment through microcredit. Many individual women have experienced some limited improvement in their economic position. They may thereby find that they have a little more leeway in their dealings with the surrounding community and that they have an increased sense of self-worth. This is obviously a worthwhile and praiseworthy development. However, such a limited and individualised form of empowerment is not necessarily sustainable in the long run. The continued practice of dowry and the escalation of dowry amounts demonstrate that development activities, including microcredit provisions, will not go very far in dealing with either poverty or the empowerment of women unless they are prepared to confront structural problems to do with class, status and gender relations. Otherwise, they are not curing the disease but simply tackling the symptoms (see, for example, Rozario 1997a).

Disciplining the workforce for global capitalism

If Grameen Bank and the other microcredit organisations are not primarily about empowering women, what *are* they about? The international popularity of GB-style microcredit, and its endorsement by the international financial establishment, are more understandable when its consonance with neoliberal economic theory is considered. As Yunus has made clear, the successful person in the GB model is a village-level proto-capitalist entrepreneur (see, for example, Rozario 2000).

However, relatively few recipients of GB-style microcredit are likely to become entrepreneurs in their own right, except in a very limited way. Most women are likely, at best, to become semi-permanent clients of one or another microcredit organisation, with the need to meet repayments as an additional pressure on an already heavily stressful working routine. In this context, it is worth looking at those aspects of *samity* membership which can be seen in 'disciplinary' terms.

The disciplinary aspects of microcredit membership, such as the semi-military structure of group meetings, the slogans recited by *samity* members, the Sixteen Decisions which GB members are supposed to subscribe to and the similar lists of principles adopted by other microcredit organisations, are quite striking. They make more sense if we see the recruitment of large parts of the rural female population into microcredit *samities* in terms of the transformation of Bangladesh into a modern industrial economy. Thus, the disciplinary aspects of GB-style meetings can be seen in the same context as the disciplinary features of work in the garment factories which are now employing around 1.5 million women, most of them from rural backgrounds, in the cities (Rozario 1997b:257–9; see also Ong 1987). Both microcredit and garment factories contribute to providing the subservient workforce required in the reshaping of the Bangladeshi economy as part of the global economic system. While the founder of Grameen Bank may have been genuine in his commitment to women's solidarity and empowerment, had microcredit really delivered in this area it would have been far less acceptable to its international sponsors. The often brutal resistance to unionisation in the garment factories gives a clearer indication of the real agenda.

Yet many of the problems of GB-style microcredit were built in from the beginning. Grameen Bank is based on the idea of the villager as entrepreneur, and this is a model that is intrinsically opposed to solidarity among villagers, among women, or among the community in any form. We would all be happy to see a 'socially responsible capitalism', but in Bangladesh GB-style microcredit was perhaps bound to develop along lines dictated by existing gender and patron–client political relations. The challenge remains of developing forms of microcredit, and other forms of social intervention, that will challenge, and in time transform, those gender and political relations.

Notes

1. Quoted in Mark Aardenberg's film on Grameen Bank (Aardenberg 1996).
2. Indeed, there appears to have been a significant increase in the number of unmarried women (well into their late 20s or over) among the urban middle class, and it is not uncommon to come across unmarried women in rural areas.
3. Interestingly, dowry was traditionally practised mainly by upper caste Hindus. Among Muslims and Christians there was a practice of bridewealth (*pon),* that is a small sum of money would be given by the groom's family to the bride's family at marriage.

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Reflections on microfinance and women's empowerment

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Introduction

Microfinance programmes for women are increasingly seen by development agencies as an effective poverty alleviation intervention, with a positive impact on economic growth and a number of social development indicators. High repayment rates are interpreted to mean that women are using loans productively and controlling credit. It is widely assumed that there is a clear and direct relationship between access to credit and an increase in the status of women within their households and communities: provision of credit is believed to lead to the empowerment of women.

This article reflects on findings from interviews over three weeks with village women's groups and staff from three NGOs in Bangladesh and one based in Bihar in India.[1] These organisations provide microfinance to women as a primary strategy for addressing poverty and empowerment. This article also draws on the authors' experience with credit programmes supported by NGOs in other parts of South Asia, and on recent literature on microfinance.

We argue that development agencies committed to the empowerment of women need to question the nature of the link between access to credit by targeting women, and the transformation in gender relations needed for empowerment and equality. Significant research and much anecdotal evidence suggest that this link is certainly not automatic (Kabeer 1998; and Mayoux 1998, Rozario this issue).

Access versus control of decision making, loan management and income from credit

- Who controls decision making regarding the use of credit?
- Who manages enterprises supported by credit, and whose paid or unpaid labour is used?
- Who controls the purchasing of inputs for these enterprises and the marketing of products?
- Who keeps, decides on and uses any income generated?

These questions are critical for understanding changes in gender relations and the contribution of microfinance to women's empowerment. Our findings indicate that only a minority of women receiving credit from poverty-oriented microfinance programmes are controlling their loans.[2] Many women are merely 'postboxes': passing on the full amount of their loans directly to their husbands, sons or sons-in-law, with little or no access to the income generated and receiving back only enough money to make weekly loan repayments. In other cases, loan management and control within the family is more complex, with some women keeping part of their loans for their own enterprises and passing on the remainder to men.

Goetz and Sen Gupta (1996:49, 60) found that, on average, only 37 per cent of loans provided by four different Bangladeshi credit organisations were either fully or significantly controlled by women, where significant control does not include control over marketing, and may thus imply little control over the income generated. Figures for BRAC were even lower, with only 28 per cent of loans controlled by women (*ibid*).

The women's groups we visited gave a varied picture of their control over decision making, loan use, marketing and profit. At one end of the spectrum, one group reported that all 25 members passed on the full amount of their loans directly to their husbands, sons or sons-in-law. Men ran the businesses (using unpaid women's labour for some tasks), and women had no access to any income generated; they received only the amount of money needed to make weekly loan repayments.

At the other end of the spectrum was a group of female trainee poultry extension workers with a minimum of grade 5 education. This group reflected a far more complex picture of female and joint female–male decision making and control of loans, with 8 of the 13 members reporting that they kept some income from the loan. The remaining women received only loan repayments from their husbands, with no access to any income generated. Some women reported that they had given part of their loans to male family members and had kept the remainder for their own business. One reported that she gave her first two loans to her husband, but she had kept the third loan for her own business because she had not got any benefit from the first two.

The issue of control over loan use and its relationship to empowerment is highly complex, with different researchers giving varying emphasis to the critical questions noted above on decision making, loan management, marketing, and control over income. For example, Goetz and Sen Gupta (1996:48) distinguish between full control over every aspect of the productive process, significant control, partial control, very limited control and no involvement whatsoever. Kabeer (1998:32) distinguishes between women as marginal, joint or primary decision makers, using a matrix which considers women's role in decision making regarding the use of the loan, participation in running the business, and the use of profits.

It is important to acknowledge this complexity in household gender relations, and to reflect on the mix of structural, individual and programme factors which influence the degree of control women are able to take over their loan. We found that few development agencies, including many key NGO staff at field level, are equipped to ask or answer questions related to male, female and joint control of credit. Our findings and other research (Goetz and Sen Gupta 1996, Mayoux 1998) also indicate that many fieldworkers may be over-estimating the extent to which women control their credit. Only one of the organisations we visited could validate their estimates on the extent of female control.

Individual or personal factors which appear to increase the likelihood of a woman controlling her loan and the income generated from it are: absence of a husband (due to death, abandonment or long-term migration); and use of the loan for a 'traditional' female activity, particularly where the woman is able to market her goods from home (such as paddy husking, sewing, selling milk or chicks). One of the key factors which constrains women in Bangladesh and India from taking control of loan use and profit is lack of access to the market for the purchase of inputs and for the sale of goods, particularly for non-traditional income-generating enterprises.

However, some traditional female income-generating activities yield extremely poor returns for labour, particularly where there is no technical assistance provided to help women to increase their productivity. For example, unpublished research undertaken by Oxfam Community Aid Abroad in Sri Lanka shows that, at best, women gain very little for their labour for many traditional income-generation activities, particularly paddy husking. Very few agencies have evaluated their programmes from this critical perspective, despite the fact that some of them target 'traditional' women's activities as a way of encouraging higher levels of female control.

Access and control over assets

A review of the literature raises serious questions about the extent to which women retain control over assets purchased as a result of credit. Kabeer finds that microfinance has been effective in increasing incomes and assets, although certainly not in the poorest households. She found that women tend to spend income, when they do control it, on household consumption and 'security-related assets' such as homestead land, whereas male loanees are more likely to invest in further productive activities (Kabeer 1998:28). More interesting from the point of view of gender transformation is whose name any new assets are registered in, and why. Kabeer found that many women continue to register land and productive assets in their husband's name, because of inheritance laws: assets will be inherited by sons if registered in the husband's name, and by daughters if registered in the wife's name (Kabeer 1998:48–50). This raises questions about any assumed automatic links between credit and transformation in gender relations but also reflects the extreme dependence of women on husbands and sons for physical security, particularly in old age.

Research undertaken by BRAC showed very mixed results regarding the impact of microfinance on whether women are able to acquire and control assets (BRAC 1998). While one study found that control of assets by women has increased due to their involvement in BRAC groups (Banu et al. 1998), another study (Halder and Husain 1998) found that both the ownership of assets and the calorie consumption of BRAC members are negatively correlated with length of membership in BRAC groups. This implies that the poorest BRAC members needed to sell some assets for debt servicing, and that they are more likely to use their loans for less productive activities and for consumption. Other BRAC research shows that, in most cases, the husband's income and other livelihood activities are essential if members are to meet their weekly instalment payments (Matin and Rab 1997). These findings also raise serious questions about the impact of microfinance on poverty alleviation.

Impact on daughters and sons: Education and workload

While the NGOs visited in our study specifically target girls for their non-formal education programs they did not appear to be collecting information on educational attainment, retention and transition rates from primary to secondary schooling for either the daughters or sons of credit group members. Drop out rates, including why and when girls drop out, are very important indicators of the impact of microcredit. Donors and implementing agencies need to investigate the impact of microfinance on labour demands for both girls and boys, and how this relates to male, female and joint control over loan use and income, and increases in women's workloads.

Impact on marriage practices

Many NGOs in Bangladesh make sweeping claims regarding the impact of microfinance provision on the incidence of early marriage, polygamy, divorce and dowry. Only one of the NGOs we visited, Proshika, collects data regularly to test these assumptions. Their monitoring indicates that divorce and polygamy are both reducing among credit group members.

Very little research has been undertaken on the impact of credit on dowry. However, anecdotal evidence suggests that dowry prices may be rising due to women's increased access to credit, despite the fact that social development training on the detrimental impact of dowry is already being delivered by NGOs. Data collected by the NGO Proshika indicate that the practice of early marriage for girls (before the legal minimum age) may be increasing, and that this may also be related to increasing levels of dowry (see Rozario this issue).

Impact on women's mobility

NGOs claim that women are increasingly 'coming out' as a result of credit programmes. Our discussions with women's groups suggest that contextual factors, such as extreme poverty and landlessness, may be more strongly associated with increased mobility beyond the village than factors to do with credit programmes. Although NGOs appear to have had some success in supporting women to travel to NGO and local government offices, much more could be done to empower and support women to enter the marketplace.

Violence against women

Most NGO staff we met believe that providing credit to women helps to reduce violence. Data collected by Proshika supports this view. All the NGOs visited include some reference to violence and women's rights in their social development programmes, and some support women's groups to take up cases of violence with local authorities. However, existing research on the impact of credit programmes on violence paints an inconsistent picture at best. Of four studies undertaken, two show an increase in violence for women who have access to credit and two suggest that it may be reducing as economic prosperity in the household improves (Goetz and Sen Gupta 1996, Kabeer 1998, Khan et al. 1998, Husain cited in Khan et al. 1998).

Our discussions with NGO staff reveal insufficient appreciation of the complex relationships between credit and violence. For example, one fieldworker told us about a woman whose husband was beating her and threatening to ask for further dowry payments if she did not bring in more credit. The fieldworker's response was to provide a loan to the woman, so her husband could purchase a rickshaw. One could argue that the credit provider here was an alternative provider of 'dowry'. There were other examples like this, equally disturbing for their lack of insight into the causes of violence. The assumption that credit, by itself, will lead to less violence is questionable and dangerous.

Self-respect and self-worth

During our discussions with women's groups, we tried to explore what women valued most about their membership in credit groups. All but one women's group (by far the poorest that we met) answered that they most valued the confidence, knowledge or training that they received. Many also mentioned the fact that they had access to credit, which enabled them to make a contribution to household finances, but for most groups this answer came second, after they had already talked about increased awareness. Some focused on their knowledge of law and rights, and others on the strength of being in a group and feeling that they could now take action against something that they knew was wrong.

Although our sample is small, the difference between male and female answers to this question was striking. Men were more likely to focus on access to money as the most valuable thing which had come from women's credit groups. NGO staff also thought that men were more interested in material benefits.

The way in which individual women respond to different programme inputs and strategies is highly complex, and depends on individual attributes as well as structural constraints and opportunities in the sociocultural environment. Our observation was that some women need only a small opportunity to build their own pathway to empowerment. With access to credit and just a little knowledge and some group support, they are able to negotiate significant increases in power and decision making within their households. We found that some women do feel that they have more respect, that they are listened to more, or that they have more 'value' because they bring in credit. But for the majority of women, access to credit and minimal social awareness inputs are simply not enough. The question that we were left asking is what more can NGOs do to build on the good work that has already been done, to support women to transform unequal gender relations in their households and communities.

Microfinance: Designed for the poor or poorest?

Our overwhelming finding was that the largest microcredit programmes – the ones that are being replicated internationally in the name of poverty alleviation – do not, and cannot, reach the poorest people. This raises very serious questions about donor rhetoric and appraisal processes. It is very clear that the poorest women either exclude themselves from credit groups, because they know that they will never be able to meet weekly inflexible repayment rates at 10–15 per cent interest, or they are excluded by group members, for the same reason. With 15 per cent of households headed by women in rural Bangladesh, and 25 per cent among the landless (Kamal 1998), it is remarkable that NGOs are not reporting on this aspect of group membership, and few donors are requiring this type of monitoring. Yet women-headed families are most likely to be among the very poorest in the community.

While this exclusion of the poorest is acknowledged in some research (Hulme 2000, Kamal 1998), it is rarely admitted by NGO staff and donors. One notable exception here is Banchte Sheka, an NGO located in Jessore in the north of Bangladesh, which has different loan packages designed to meet the needs of women from different socioeconomic groups, including interest-free loans, group loans, loans at 5 per cent interest rates, and loans with long grace periods before repayments are due, with women graduating to market rates once they have received enough training and gained enough regular income to be able to repay. Donor agencies have a clear obligation to investigate the impact of microfinance on the poorest families, and implementers need to acknowledge that one microfinance package cannot possibly meet the needs of all rural poor.

Strategies to support women's empowerment and transformation in gender relations

Our observations suggest that the following programme factors will increase the likelihood of a woman controlling her loan and the income generated from it:

- understanding of gender issues and women's rights by the NGO fieldworker, and a commitment to equality for women;
- close monitoring by the NGO of different aspects of control over credit and other aspects of empowerment;
- clear messages from the NGO regarding the importance of women having some control over decision making, loan use and ownership of any income and assets generated. While most NGOs have social development training inputs integrated with their loan packages, what appears to be needed are very strong group and popular education methods which promote women controlling loans and emphasise women's rights within the household and community; and
- technical training inputs which support women to manage and use the loan themselves, and which focus on increasing the productivity of their labour.

Other programme strategies worthy of further investigation include:

- training in marketing, and/or improving access to markets, including investigation of group marketing initiatives by women;
- more investment in activities which help to change men's attitudes to women; and
- using female rather than male fieldworkers. Although some organisations visited have a clear commitment to increasing the numbers of female staff and their seniority, female fieldworkers are still in a minority, and there appears to be little or no debate on how this affects work with women's groups.[3]

Conclusion

Poor women and men in the developing world need access to microfinance and donors should continue to facilitate this. Research suggests that equity and efficiency arguments for targeting credit to women remain powerful: the whole family is more likely to benefit from credit targeted to women, where they control income, than when it is targeted to men (Kabeer 1998, Khandker 1998, United Nations 1995:118). However, donors and implementing agencies need to significantly improve the design and monitoring of microfinance programmes to ensure that they support the empowerment of women. More reflection and documentation are needed on specific programme strategies which assist women to take greater control of decision making and life choices.

Microfinance must also be re-assessed in the light of evidence that the poorest families and the poorest women are not able to access credit. A range of microfinance packages is required to meet the needs of the poorest, both women and men. Donors need to revisit arguments about the sustainability of microfinance programmes. Financial sustainability must be balanced against the need to ensure that some credit packages are accessible to the poorest.

Notes

1. Organisations visited included: Bangladesh Rural Advancement Committee (BRAC), Proshika and Banchte Sheka in Bangladesh, and Nav Bharat Jagriti Kendra (NBJK) in India. The weaknesses of microfinance programmes identified in this paper do not refer to Banchte Sheka.
2. The term 'poverty-oriented' refers to those programmes which provide small 'collateral-free' loans to women in credit groups (500–5,000 Taka in Bangladesh), rather than programmes that provide larger loans, which may be linked to local banks (5,000–500,000 Taka) and which require either collateral based on property deeds or personal guarantees.
3. This contrasts with a Bangladesh project included on the UN Development Programme's good gender practice website, which reports that recruiting and training women project staff have proved effective, due to strong sex segregation pressures in Bangladeshi society. See case study on 'Bangladesh: Poverty alleviation in Kishoreganj' at http://www.sdnp.undp.org/

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Microfinance and women's empowerment: Rethinking 'best practice'

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Introduction

In the 1990s microfinance targeting women became a major focus of gender policy in many donor agencies. Literature prepared for the 1997 Microcredit Summit, donor policy documents and NGO funding proposals all present an extremely attractive vision of increasing numbers of expanding, financially self-sustainable microfinance programmes reaching large numbers of women borrowers. Through their contribution to women's ability to earn an income, these programmes are assumed to initiate a series of 'virtuous spirals' of economic empowerment, increased well-being for women and their families and wider social and political empowerment. However, more recently, as the findings of research and experience have filtered through, this initial enthusiasm is being replaced by scepticism.

Here it is argued that, although the widespread complacency about the automatic benefits of microfinance for women needs to be questioned, the shortcomings of existing practice should stimulate the search for improvement and innovation, rather than provide the basis for cynical inaction. It is not microfinance *per se* which is the problem, but the ways in which 'best practice' has become dominated by concerns of financial sustainability. Innovations in some programmes point to a range of ways in which microfinance's contribution to empowerment can be increased as part of a broader strategy for gender transformation.

Questioning 'virtuous spirals'

Microfinance programmes have significant *potential* for contributing to women's economic, social and political empowerment. Access to savings and credit can initiate or strengthen a series of interlinked and mutually reinforcing 'virtuous spirals' of empowerment (see Figure 1).

- Women can use savings and credit for economic activity, thus increasing incomes and assets and control over these incomes and assets.
- This economic contribution may increase their role in economic decision making in the household, leading to greater wellbeing for women and children as well as men.
- Their increased economic role may lead to change in gender roles and increased status within households and communities.

These virtuous spirals are potentially mutually reinforcing in that both improved wellbeing and change in women's position may further increase their ability to increase incomes and so on.

This process of empowerment may be further reinforced by group formation focusing on savings and credit delivery:

- Women can access wider information and support networks for economic activity.
- Groups can support women in disputes within the household and community.
- Groups can link to wider movements for change in women's position.

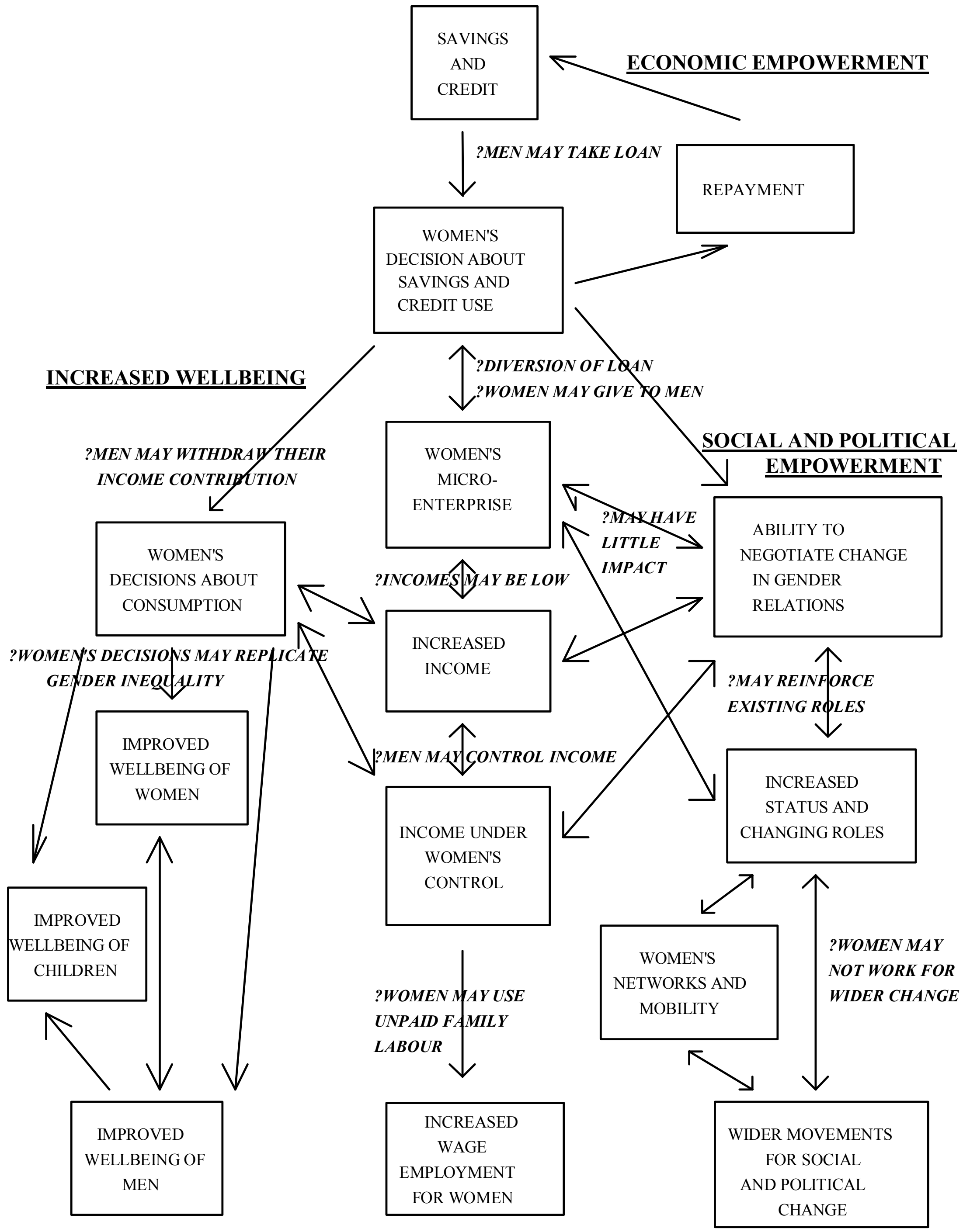
However, these changes are not an automatic consequence of savings and credit alone or of group formation. Evidence suggests that, even in financially successful microfinance programmes, *actual* contribution to empowerment is often limited:

- Most women remain confined to a narrow range of female low-income activities.
- Many women have limited control over income and/or what little income they earn may substitute for former male household contributions, as men retain more of their earnings for their own use.
- Women often have greater workloads combining both production and reproductive tasks.
- Women's expenditure decisions may continue to prioritise men and male children, while daughters or daughters-in-law bear the brunt of unpaid domestic work.
- Where women actively press for change, this may increase tensions in the household and the incidence of domestic violence.
- Women remain marginalised in local and national level political processes.

This is not just a question of lack of impact, but may also be a process of disempowerment:

- Credit is also debt. Savings and loan interest or insurance payments divert resources which might otherwise go towards necessary consumption or investment.
- Putting the responsibility for savings and credit on women may absolve men of responsibility for the household.
- Where group meetings focus only on savings and credit, this uses up women's precious work and leisure time, cutting programme costs but not necessarily benefiting women.

Fig.1 VIRTUOUS SPIRALS : QUESTIONING ASSUMPTIONS



- Repayment pressures may increase tensions between women and/or lead to the exclusion of the most disadvantaged women who may then be further disadvantaged in markets and communities.

Impacts are therefore very complex. Women themselves are not passive victims, but active participants using opportunities as best they can in the context of the many constraints of gender inequality and poverty. There may be trade-offs for individual women because of reinforcing and conflicting opportunities and constraints. At both household and community level different women may be affected in different ways.

Rethinking 'best practice'

There is a need for much greater clarity in the underlying vision of microfinance programmes. This clarity entails a definition of empowerment which goes much further than either women's access to microfinance access or household-level poverty alleviation. Providing an adequate and non-discriminatory regulatory framework for microfinance needs to be seen as a human rights issue, rather than the end aim of gender policy itself. Poverty alleviation as measured by increased income is not sufficient for women's empowerment because intra-household inequalities mean that women do not necessarily benefit from increases in household income, even where they are major contributors. On the other hand, although women's empowerment is an essential component of poverty elimination, 'women' cannot be treated as an undifferentiated category. Specific strategies may be needed for the poorest and most disadvantaged women. Importantly, addressing gender inequalities in power and resources requires a holistic view, integrating productive and reproductive work and addressing practical as well as strategic needs and interests. It also requires consideration of ways in which microfinance provision for men can be a mechanism for challenging gender inequality.

Translating this empowerment vision into practical policies requires firstly mainstreaming empowerment concerns throughout all aspects of programme implementation and decision making as well as effective women-targeted initiatives. There was a clear qualitative difference, in the programmes studied by the author, between those where empowerment issues were raised as a routine part of all interactions between staff and clients, and those where staff belittled gender issues and failed to question gender stereotypes or suggest ways in which women could overcome gender-based problems. An integral part of this empowerment vision is women's participation in programme decision making.

Conditions of microfinance delivery

Conditions of microfinance delivery are often seen as a technical banking issue, decided from above by programme staff and/or donor consultants. The main consideration is financial self-sustainability or, more rarely, poverty targeting. Very little deliberate and strategically designed attention has been given to empowerment questions. However, evidence indicates that women's ability to use microfinance to increase incomes and control these incomes is also affected by details of the conditions of microfinance delivery.

Current debates have been preoccupied with setting interest rates high enough to cover the costs of service provision. However, equally as important are repayment schedules and methods of interest calculation. These have a critical impact on women's ability both to profitably use loans and to control the loans and incomes. The repayment schedules and methods of interest calculation preferred by women vary between context and type of programme and must be based on a process of participatory consultation. For example, in Cameroon's Gatsby Trust, women preferred fixed rates which they could calculate themselves. In the Bangladeshi NGO Community Development Centre (CODEC), by contrast, fishworker women preferred declining balance repayments because these enabled them to immediately pay back any money they earned and prevent this being diverted into other purposes by their husbands. CODEC also fixed individual repayment schedules with borrowers and rewarded or penalised performance in relation to the agreed schedule. This flexibility had a positive impact on both repayment and incomes and also encouraged borrowers to take a more strategic approach towards loan use.

One of the central emphases in proposals for best practice has been changes in collateral requirements to include female-owned assets and 'social collateral' in the form of women's group guarantees. However, an empowerment approach needs to go further and require any assets purchased with loans to be registered in women's names, both as insurance against default and as a means of increasing women's control over assets. This is the case in some programmes, including Grameen Bank. There could also be a requirement for men's loans to be registered in joint names. This is particularly the case with larger loans for house purchase, land acquisition or other productive assets such as rickshaws.

Most discussions of loan size have asserted that women need smaller loans. Although this is true for initial access and for very poor women, there is a danger of 'ghetto-ising' women within small loan programmes. There is also evidence of prejudice by male staff against granting larger loans to women. Case studies collected by the author indicate that many women want access to larger loans and are capable of managing them. Such loans could be made conditional on registration of assets in women's or joint names and evidence of women's involvement in the loan activity, including marketing and accounting and production of business plans. These in themselves could give women more confidence and skills in taking a strategic approach to savings and loans rather than simply drifting into debt.

Within the financial self-sustainability paradigm, there is some disagreement about the degree to which loans can or should be directed towards particular purposes. Close monitoring may not be necessary in programmes targeting existing female entrepreneurs and/or where gender norms give women control over much of their own income, as is the case in many African programmes. However, in CODEC in Bangladesh, women were opposed to donor proposals to reduce loan monitoring. They said that, unless loans were explicitly directed by the programme towards their own productive activities, the loans and incomes would be taken by men. Another way round the problem of loan diversion is also to make loans available to both men and women for particular types of consumption, for example daughters' education, school fees in general, health care, and house improvement. This could also serve to reinforce men's responsibility for their households.

For many women, including very poor women, savings facilities are as important as loans in increasing amounts of income and assets under their control. However, women may already have effective ways of saving, including revolving savings and credit associations and 'trouble funds' in Africa which provide a safety net for very poor women. Where the main concern is programme financial sustainability, NGO savings programmes and low-interest and unsuitable saving schemes may divert women's scarce resources from investment and/or consumption, decreasing profits and harming their nutrition and health.

Complementary services

The multidimensional and all-pervasive nature of gender inequality means that there is an infinite array of needed and potentially useful services. However, financial sustainability requirements have led many programmes to drastically cut complementary services. Some, including business training and gender awareness, are both expensive and have minimal impact. This does not mean that complementary services are not needed but that they need to be improved. What is required is a careful analysis of needs and priorities and then consideration of a range of possible ways in which they can be met. Some services could be supported partly through cross-subsidy from charging for other services, like business services for better-off men and women. Other service needs could be met through a combination of building on group structures, integrating and mainstreaming service provision with microfinance activities and interorganisational collaboration, as discussed below.

Rethinking group structures and functions

There needs to be a change of emphasis from viewing groups simply as a repayment mechanism to looking at ways of 'building on social capital' (Mayoux 1999). This can be done by helping groups to develop their own empowerment strategies and linking them with women's movements and other organisations.

There is an important role for groups as a forum for information exchange and mutual learning. This includes, for example, successful women entrepreneurs within programmes sharing their experiences with others (that is, skills exchange). Both Small Enterprise Foundation in South Africa and CARE-PROSPECT in Zambia are developing ways of using PLA methods to facilitate information exchange. Interviews by the author found that many women would be prepared to help train other women and groups would be prepared to pay for such training. This would require programmes to play a facilitating role by, for instance, collecting information on training needs and training skills as part of programme registration, and creating a computer register.

In some cultures, savings and credit groups provide one of the few socially acceptable forums for women to come together to discuss gender issues and organise for change. However, they may need support, particularly in the form of information, organisational and leadership skills, and also in the actual strategies they decide to employ. Male support also needs to be encouraged through development of new role models and developing male networks for change. Some mixed-sex programmes, like CODEC in Bangladesh and Cercle international pour la promotion de la CREation (CIPCRE) in Cameroon, have been very effective in organising men alongside women to address issues of domestic violence and abandonment of women. Microfinance programmes also provide a potentially large and organised grassroots base for developing advocacy and lobbying strategies around gender issues.

Organisational gender mainstreaming

Donor agency statements of commitment to gender mainstreaming have so far failed to be reflected in microfinance guidelines. Equal opportunity policies need to be an integral part of institutional strengthening. Evidence indicates a clear linkage between levels of female staff and women's access to microfinance. However, equal employment of female staff is not in itself sufficient to ensure empowerment outcomes for programmes. Women staff, like men, frequently lack expertise in gender analysis and may not have sufficient knowledge or experience of the situation of very poor women. There is, therefore, a need for gender training for both male and female staff. This training needs to identify priorities for gender policy at client level and how women's participation can be increased at all levels. It also needs to identify necessary changes in organisational culture, recruitment criteria and procedures to ensure equal opportunity becomes a reality at work. This would also enable female and male staff to overcome the many gender challenges they face in their lives outside work.

Structures for implementation of gender policy need to go beyond appointment of a junior member of staff to the position of gender officer and/or allocating a small percentage of time from different staff to gender issues. There need to be clear lines of responsibility, adequate resources and formal forums for exchange of information and ideas. These in turn require clear guidelines and concrete incentives for implementation of empowerment policies if both female and male staff are to feel confident about spending scarce time and resources on these issues.

There is also a need to rethink current orthodoxy on the separation of microfinance from other interventions. Providing that repayment incentives are built into credit delivery, integrating the role of credit officer and development worker improves staff–client understanding and decreases time spent chasing bad debts. On-going mentoring and counselling by staff both for enterprise and gender at savings and credit meetings is often more effective than one-off 'expert' training and decreases transport and other costs for both programmes and clients. A number of programmes researched by the author were successfully integrating credit and savings delivery with human development and training activities.

Creating incentives requires integration of empowerment indicators into programme monitoring and evaluation to assess the impacts of programmes on the lives of participants, and also to assess the potential contribution of programmes to empowerment. Small Enterprise Foundation has been looking at cost-effective ways of integrating poverty indicators (Mayoux and Simanowitz 2001). These methodologies could also be further developed to include empowerment indicators (Mayoux 1998b).

Interorganisational linkages

Even where gender issues have been fully mainstreamed into microfinance and other services, there will still be a need for special training and support. This is particularly the case for women's rights training for women (and also men), legal and other support for women with particularly difficult household situations, special training and/or marketing support for women to enable them to enter new or 'male' economic activities. All these services do not need to be provided by the programme itself, but, where cooperation with other programmes cannot be relied upon to fill these needs, they should be incorporated into the programme in question.

Interorganisational collaboration is one way of reducing the costs of developing new strategies and services. The development of training courses and/or research could be done by pooling the resources of several programmes. Programmes could also link with other specialist providers. This could take the form of advertising the availability of other services, referring clients, or programme/ group/ individual payment for particular services. It could at a minimum entail drawing up a list of such organisations and agreeing to keep their publicity material at loan disbursal points, or making a list of possible speakers available to groups. This would both increase the contribution of microfinance at minimum cost and give service providers ready access to a sizeable and organised constituency of poor women, which would in turn also contribute to their sustainability.

Some who have been influential in organisations promoting the financial self-sustainability approach advocate macro-level changes in the civil code and property laws to give equal inheritance rights, enable married women to hold property and access financial services in their own names (Berger 1995; for USAID's experience, see Downing 1990). These are only some of the barriers which women face at the macro level and which limit their ability to effectively use microfinance services. However, gender issues have been completely absent from advocacy activities of most microfinance NGOs. It is crucial that microfinance programme staff think through the range of support needed by women for empowerment and to link strategically with other forces for change, including women's own networks, women's movements and advocacy organisations and gender lobbies within donor agencies. This is being done effectively by the Self Employed Women's Association and other NGOs in India, although there are many challenges and much more remains to be done.

The need for a new participatory aproach

Women need a diversity of provision, both in view of their own individual needs for different types of savings, loans, insurance, pensions and so on, and in view of differences in needs between women. There is a range of microfinance models into which elements of this empowerment strategy could be implemented, from mainstream banks and financial service providers through large poverty-targeting banks to smaller microfinance programmes providing savings and credit to members of women's movements and labour organisations.

An empowerment approach does, however, involve a significant change in attitude and work practices and the challenging of vested interests. Flexibility to women's needs and deciding the best ways of combining empowerment and sustainability objectives can only be achieved on the basis of extensive consultation with women, research on their needs, strategies and constraints, and a process of negotiation between women and development agencies. It therefore inevitably requires a more comprehensive framework for women's participation at all levels, rather than imposition of particular models depending on the particular donor fashion extant at the time.

Finally, despite the potential contribution of microfinance programmes to women's empowerment, realising this contribution is dependent on, rather than a substitute for, adequate welfare provision and feminist mobilisation. What is particularly worrying about the current situation is that financially sustainable minimalist microfinance is being promoted as the key strategy for poverty alleviation and empowerment in response to ever-decreasing official development assistance budgets. Unless microfinance is conceived as part of a broader strategy for transformation of gender inequality, it risks becoming yet one more means of shifting the costs and responsibilities for development onto very poor women.

Note

This article summarises research done under a research fellowship for the Open University, Milton Keynes and a series of consultancies including DFID, UNIFEM and ILO. This is discussed in more detail in Mayoux (1998a, 1998b, 1999, 2000, 2001). Full references to the evidence can be found there.

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Research and innovation agenda of the INCOME project

Carlos Ani, CARE, Bangladesh

Introduction

The purpose of the INCOME III project of CARE Bangladesh is to enable the delivery of a wider diversity of financial services to poor people, including the extreme poor, with a focus on urban and peri-urban areas. Currently, there is a lack of new or innovative financial products in the market, and poor people have little access to financial services that meet their needs. In short, there are unmet needs.

INCOME stands for 'Increasing Capacity of Organizations in Microfinance'. It has a research and innovation component where CARE sponsors research studies and action research pilot programmes to help develop new financial products. It provides technical assistance and financial support to partners to develop innovative services (such as flexible savings, microinsurance, microleasing and other microcredit products) that are appropriate to the needs of the poor.

This is with the aim of reaching the extreme poor and those poor households that have little access to financial services. But the vulnerable non-poor and the enterprising poor are also disadvantaged, because of the lack of services meeting their needs. The project will encourage innovations that also serve these groups.

The proposed activities to be carried out under INCOME III are described below. This article is intended to stimulate discussion that will help CARE Bangladesh and its partner organizations to finalise this agenda as a guide to its programming over the next four years.

Theme 1: Understanding the needs of urban poor households

CARE and its partner NGOs have to fully understand the needs of urban poor households in order to design or improve appropriate financial products and services for them. Other microfinance methodologies available in Bangladesh must also be examined for their potential to reach more people or sectors than have been served before.

To better understand the financial services needs of urban poor households, INCOME conducted the 'Urban Financial Services Study (UFSS), Part 1' in mid-1999 in three cities (Dhaka, Chittagong and Khulna). The second UFSS will be carried out in several secondary cities/towns (suggested ones are Rajshahi, Jessore, Sayepur, and Bogra). Its specific objectives will be:

- to identify financial services needs (such as savings, credit, insurance);
- to identify the various vulnerabilities of urban poor/slum areas;
- to construct a profile of the households, by analysing their socioeconomic characteristics, ethnic origins, occupational classes, educational attainment, and religious and political affiliations;
- to identify available financial services and analyse their major merits and demerits. This will include examining the services provided by organised sectors (banks, NGO-MFIs, cooperatives, finance companies, life insurance companies) and informal sectors (loteri samiti, informal moneylenders);
- to suggest improvement, or the development of new financial products and services that will address the identified needs; and
- to identify potential partners in the new area of operations.

The predominant microfinance model being used in Bangladesh is the Grameen model. Clients have no ownership of the financial institution and little participation in its decision making. The extreme poor are also excluded because group members naturally do not want to include in their groups the very poor in the communities, as they are seen as liabilities. Therefore, other microfinance schemes in Bangladesh will be studied, such as credit cooperatives and self-help groups (SHGs), both of which are client owned and managed. The specific objectives will be:

- to gather all relevant secondary data on cooperative and SHG successes and failures;
- to identify successful cooperative models and SHGs or SHG-promoting institutions with microfinance operations and examine the reasons for their viability;
- to identify the key reasons for failure of previous cooperative and SHG models; and
- to identify any other available models or approaches.

The purpose is to explore possibilities for supporting sustainable SHG and cooperative models that serve urban and peri-urban poor households.

Theme 2: Developing micro health insurance schemes

Poor people have little or no access to high quality medical and health care services. Two reasons are the high cost of such services and the inaccessibility of public health care services. With the aim of extending affordable medical care to thousands of urban poor households, INCOME will develop one or two appropriate micro health insurance products that can be implemented by small or medium-sized NGOs or cooperatives. The objectives of the micro health insurance schemes study will be:

- to gather all relevant and reliable empirical information on the few micro health insurance schemes that have been tried by NGOs and development agencies in Bangladesh;
- to determine the key aspects of sustainability;
- to discover the causes of previous failures;
- to identify fairly successful models and the reasons for their survival; and
- to identify the variations between schemes that are still operating.

The study will include five or six detailed case studies, including two to three cases already prepared by the HEU-ILO consultants. It will also gather existing research material on this subject.

On the basis of this research, INCOME will design and pilot test one or two micro health insurance schemes. CARE will hire staff to implement this pilot, and partner NGOs will be selected to work with CARE which will provide the grants and technical assistance. The NGOs will establish service delivery infrastructures (consisting of branch office and clinics) to extend services to around 5,000 client beneficiaries. The pilot project will be implemented over two years, but may be extended if necessary, and will be evaluated at the end of the period.

Theme 3: Developing appropriate shelter financing services

Through site visits and discussions with many urban poor households during 2000–01, INCOME has identified an urgent and basic need for housing and shelter. These households are usually living in squatter or slum communities, where land tenure is insecure and sudden and forcible eviction common. The objectives of this study will be to identify the usual land tenure arrangements in these communities, and the nature and size of the demand for housing; and to examine the features and performance history of the various housing products or shelter financing programmes that cater to these households. The purpose is to identify demand and existing products, and to use this information to design an appropriate housing loan/shelter financing product that will be viable in the long term.

On the basis of information gathered, INCOME will design and implement a simple action research programme. CARE will work with partner NGOs to design an appropriate housing loan/shelter financing product. The NGOs will then offer this product, on a pilot basis, to qualified clients. INCOME may tap local commercial banks as partners or financiers in this programme. At the end of the two-year pilot, an evaluation will be done.

Theme 4: Developing appropriate savings services

The dominant approach in Bangladesh excludes the poorest, upper poor, entrepreneurial poor, and lower middle class clients who belong to the vulnerable non-poor group. It also excludes people who cannot attend the weekly meetings that are usually required under the traditional model. SafeSave has pioneered a new approach, using flexible savings and credit methods that have been shown to be more effective in reaching these groups.

INCOME has launched a research project replicating the SafeSave approach. The project will pilot test a new microfinance methodology under a pilot sub-project called 'Family Savings Pilot' (FSP), based on research findings that urban poor households want flexible savings products, especially where deposits can be made in varied amounts and savings withdrawn in case of need. FSP will provide opportunities to reach more poor people, especially the extreme poor, to save and borrow money. It will have a strong emphasis on installing and maintaining sturdy financial information systems to enable efficient and accurate tracking of thousands of savings and loan accounts. CARE has selected two partner NGOs to replicate (with some modifications) the products of SafeSave. CARE will work collaboratively with SafeSave and PLAN International on the technical areas to support training and provision of technical assistance to these partners.

The demand for savings services in Bangladesh is very high because people generally do not have access to banks. The NGOs, on the other hand, do not have the appropriate systems and technologies to mobilise savings, especially the voluntary type, given their traditional approach on microcredit. Current laws and regulations do not allow NGOs to mobilize savings from the public, but there are moves now to establish a more enabling legal environment. INCOME will identify or develop an appropriate savings mobilisation and tracking system that is appropriate to urban Bangladesh, and install it among 5–10 interested core partners. This is expected to significantly improve the ability of MFIs to mobilise and manage savings. There is an issue, however, that large replication of this approach is not possible if the legal authority of NGOs to mobilise savings remains unclear.

Theme 5: Developing micro life insurance services

Poor people face risks related to untimely death. They have no access to traditional life insurance services. Several life insurance companies have started to offer low-cost policies that serve low-income households but which are not yet accessible to poor households. Major MFIs like Grameen Bank, Association for Social Advancement (ASA) and Bangladesh Rural Advancement Committee (BRAC) have introduced micro life insurance schemes (though they are not described as 'insurance') to test acceptance and viability. Small NGOs are interested but have no technical and institutional capacity to do so.

INCOME intends to help interested small partner NGOs to develop appropriate micro life insurance services. CARE will develop a small action research programme and work with a life insurance company, a cooperative providing insurance services, and several local NGOs. The purpose is to develop a sustainable mechanism by which affordable life insurance services can be offered to thousands of poor households, using local NGOs and cooperatives as channels.

Theme 6: Other innovative products and services

A number of organisations have started to introduce new or innovative products and services for the poor and for those with enterprises, small and micro. The project is interested to know more about microleasing, microenterprise loans, and other forms of financial services. It may conduct one or two studies, which may include a financial products survey, to determine the types of financial services that are being tried out by various service providers.

The main objectives are to identify: the fairly successful models of micro-leasing and asset-backed products in Bangladesh; and the various types of microcredit services that focus on micro and small enterprises (higher loan sizes, longer terms, and so on).

Credit bureau

There is a growing problem of overlap and geographic competition among MFIs in Bangladesh, especially in dense and highly populated areas. It is not unusual to see several NGOs working in the same slum area. While this is good for the poor in that they tend to have more choices regarding their service providers, the growing competition has led to situations where some households have loans from several different MFIs and are defaulting on most or all of them. The MFIs are reluctant to cooperate with each other, and they are beginning to have serious problems with client selection.

The INCOME project will collaborate with PKSF (Palli Karma Sahayak Foundation, the country's apex financial institution or other stakeholders) in establishing a pilot credit bureau in a small thana or locality, so that adequate information can be obtained from various MFIs that can help in better client selection. A good credit bureau can also provide a collective sanctioning mechanism for wilful defaulters and cheats. This pilot may be started in the third or fourth year of the project.

Liquidity pool

It has been observed that NGOs and microfinance organisations are vulnerable to some seasonal liquidity crisis situations. For example, the demand for credit and savings withdrawal is very high before the major religious festivals (Eids) and right after a major natural disaster. There is currently no liquidity financing mechanism in Bangladesh for small and medium-sized NGOs/MFIs. The project will establish on a pilot basis a liquidity pool to enable partners to manage sudden liquidity needs.

Research and Innovation Fund

The project will establish a Research and Innovation Fund (RIF) to make funding available for organisations to explore innovative approaches to furthering microfinance in Bangladesh. The major goal is to contribute to poverty reduction through improved MFI practices, products and systems.

The Fund will be launched through a series of seminars for MFIs and interested organisations in order to stimulate creative thinking and to emphasise the need for new approaches. Financing for selected RIFs will be mainly in the form of small grants, with a small portion of soft loans. All proposals must relate to at least one of the following key themes:

- Using microfinance to improve the livelihoods of vulnerable groups.
- Improving or designing microfinance products.
- Improving the governance, management and systems of MFIs.
- Identifying and promoting synergies and linkages between MFIs, local commercial banks and funding institutions.

The following are tentative criteria to be used in assessing RIF applications:

- The proposal must address a real need relating to microfinance and poverty reduction.
- The end users are identified; that is, who will benefit?
- The research must be in line with at least one key theme.
- The RIF is open to all legally constituted Bangladeshi organisations or international organisations legally allowed by the government. This includes universities, NGOs, community based organisations, commercial companies, the public sector, and international NGOs with local branches. Partnerships between different sectors are encouraged.
- There may be an element of risk in the work proposed – the end results may not be clear, or even certain, at the outset of the work, but those risks are clarified and assessed up front.
- Preference will be given to those product ideas that are highly attuned and responsive to the needs of the extreme poor.

The size of most supported activities will not usually exceed Tk. 2 million. Larger applications may be considered, however, if they are of particular high quality and involve more than one partner. Given budget limitations, no more than 7-8 RIFs can be supported during the life of the project.

CARE's role in the Fund will encompass the following:

- RIF management, involving advertising, production of easily understandable guidelines and a pro-forma for applications, collection and review of proposals, subsequent negotiation and management of the activities.
- Facilitating linkages between organisations conducting or interested in similar or complementary aspects of microfinance.

- Encouraging synergies and cross-fertilisation of ideas. As the privileged focal point for ideas, CARE will share experiences and findings (through workshops, conferences, seminars, electronic media, and possibly publications).
- Feeding lessons learnt into practice throughout the life of INCOME III and into other relevant initiatives by CARE and others.
- Conducting research, learning and/or dissemination activities with other organisations or alone during the life of the project.

INCOME will encourage research and innovation in the areas described in Table 1, but applicants are not limited to these.

Table 1 Tentative areas for research and innovation

Area of research/ innovation	Need that it is trying to address
Microenterprise loans	Micro-entrepreneurs and shopkeepers need larger loans than are currently available.
Micro-leasing	Microenterprises such as metalwork or repair shops often need equipment.
Micro life insurance products	Because of the present limited information about micro insurance, there is a need to study, refine and develop suitable products based on available experience and local context.
Health insurance products and health care/maintenance plans	Malnutrition and morbidity rates remain very high in urban slums, so there is a major need for affordable insurance that covers health care costs. Several health care schemes have been developed but no systematic study has been done to catalogue and assess them.
Asset-backed loans	Typical loan products cannot meet the needs of microenterprises and other clients who need bigger loans. Loans could be backed by land or equipment.
Housing loan and savings products	Poor urban and rural households urgently need assistance to construct or repair their homes.
Disaster loans	Bangladesh is vulnerable to frequent natural disasters. It is necessary to develop loan products that provide financial assistance to disaster victims. CARE has recently introduced 'emergency loans', and other organisations have started their own products.
Vocational training loans	The UFSS has shown that urban people want skills training so they can increase their earning potential. There are no financial products linked to vocational training.
Credit bureau	To avoid overlap of MFI coverage and to facilitate information sharing, a clientele database needs to be established in each area.
Savings schemes for weddings and old age	Bangladeshi weddings are expensive and often entail families having to go into debt to finance them. A long-term savings product is needed to help poor households with such expenditures. Standard long-term savings products are also necessary to meet old-age needs.
Loans for community improvement	Slum communities need basic services (schools, clinics, water supply, toilets, garbage disposal). The project could experiment with loans for providing such amenities.
Account management bureau	Small MFIs and cooperatives cannot find and afford high quality accounting, financial and computer professionals to operate good financial information systems. A feasibility study could be conducted to determine prospects for establishing an account management bureau which would provide these services on a commercial basis.
Training voucher system	A pilot 'training voucher system' is needed to allow greater options for obtaining training for NGOs and other development organisations. It would also allow more donors to invest in capacity building and encourage the development of more professional, privately owned training providers.
Employee provident fund	MFI employees receive no fringe benefits (health care, sickness/hospitalisation, loan services, retirement pensions). A feasibility study could assess the situation, measure demand and prepare a proposal to establish a multi-employer provident plan.
Flexible savings for the community	MFIs need to develop flexible savings products that allow them to tap a wider base of savers and clients.
Computer based accounting system for MFIs	Almost all MFIs use manual bookkeeping systems that are too unwieldy and prone to error. Existing computer-based financial information systems could be assessed, recommendations made and assistance provided for installing such systems.

Bougainville microfinance: Rebuilding rural communities after the crisis

John Newsom, Bougainville Microfinance Scheme

Introduction

Long before the fighting had finished, planning began for the reconstruction of Bougainville. In 1996, the author was invited to meet the Bougainville Transitional Government (BTG) to help devise a rural finance scheme. With the conflict continuing in the background, a series of participatory workshops was held with grassroots people from all over the province. Based on the financial and community development needs they identified and on their design, the Bougainville Microfinance Scheme (BMFS) was formed.

By late 1998 BMFS was sufficiently advanced to attract substantial AusAID funding. It also attracted counterpart funds from the Bougainville administration. Phase 1 began in four pilot areas that had been selected for testing at the people's workshops. A central federated body, Bougainville Haus Moni (BHM), was formed, and it would thereafter coordinate all development on a locally directed basis. Development was supported by two Australian non government organisations (NGOs): Australian Volunteers International (AVI) and Credit Union Foundation Australia (CUFA).

Despite some competition from other microfinance institutions (MFIs) and severe inroads on members' savings by pyramid money schemes, the BMFS pilot areas flourished. Phase 1 targets were exceeded by early 2000. Design work then began for AusAID's Phase 2, which would be a three-year project let out to competitive tender. This phase began in the last quarter of 2001, with AVI/CUFA having been retained as the managing contractors.

The development of BMFS displays some design features that have been shaped by the Bougainville crisis and its aftermath. Some of these circumstances are replicable but many are not. The project has been designed, by the member/owners themselves, to be ultimately sustainable. It will be savings based, yet will provide a comprehensive range of loan and other services through a multi-tiered financial intermediation system. It is without question, therefore, an MFI that displays all the features of the institutional model. It is already achieving both broad and deep outreach. As it grows in tandem with more formal elements of the Bougainville economy, it can contribute greatly to the engagement of people at the grassroots in social and economic development.

Political issues – talking to both sides

The introductory workshop in 1996 was held just two weeks after BTG Premier, Theodore Miriung, was assassinated. Miriung had been an inspirational planner for peace, and his killing created an intense environment in which solutions for peace were being actively sought. BMFS immediately became one of those solutions. From the very start it was supported in its grassroots form by a number of prominent officials in the BTG administration, most notably the Assistant Secretary, Commerce, Albert Kinani, who still serves as a skilled adviser on the BHM (peak) board today.

Favourable though the climate was, it was nevertheless exceptional that the conclusion drawn at the preliminary workshop of BTG leadership was that the new MFI should be owned and directed by people at the grassroots. This unusual abnegation of power and influence was a key factor in the early development of Bougainville Haus Moni Scheme. So too was the provision of funding by the BTG, which enabled people over the following year to make the often hazardous journey to the relative safety of Buka town in the north for design workshops. (Similar funding has been provided for the life of the project so far.)

Valuable though this support from the BTG was at that time, it carried within it a possible derogator of ultimate success. Present support from the BTG might lead to ultimate dismantling by the opposition BRA/BIG (Bougainville Revolutionary Army/ Bougainville Interim Government) when the conflict was eventually over. The Australian development advisers therefore turned to the strong network that existed between Australian NGOs and elements of the BRA/BIG, in particular to Moses Havini who was the rebels' emissary in Australia. The BRA/BIG was constantly informed through that network of what BMFS was doing and what its ultimate objectives were. Consequently, when the BRA/BIG later came to form the majority in the Bougainville People's Congress, BMFS was secure and its counterpart funding base even increased.

Early design workshops

It is a common practice for international development organisations and NGOs, when implementing a poverty-alleviating community development project, to introduce some aligned microfinance facility. In the majority of cases the add-on facility is a revolving credit scheme, roughly but not always exactly replicating the Grameen Bank of Bangladesh and mainly targetting the welfare and income-generating capacity of women. There have been many cases where women have been encouraged to lift themselves out of poverty by having access to sometime cheap loans that allow them to engage in income-generating activities. There have also been many cases where the model has been inappropriately applied.

The European Union and at least two overseas NGOs have attempted to introduce revolving credit schemes to Bougainville.

This is not the place to explore in any depth the intense controversy that has taken place between the 'welfare' and the 'institutional' approaches to microfinance. For deeper analysis of the institutional approach that has come to be adopted by BHMS, see Ledgerwood (1998), Otero and Rhyne (1995) and Robinson (2001). The core of their argument is that it is only through an institutional approach that an MFI can become sustainable in the longer term and reach out to the greatest number of clients (to which the counter has been that institutional MFIs have difficulty reaching the poorest of the poor).

The key to the design of BMFS was that it was carried out by the people themselves through participatory workshops. The facilitator provided an array of microfinance activities from elsewhere in the world for workshop consideration. Financial intermediation – where the institution, like a bank, acts as 'broker' between depositor and borrower – and its role in supporting economic development was, however, explained in depth. In the end no one external model was chosen for replication.

In all cases, from all parts of Bougainville, the first choice from among the array of financial products was for a savings facility. This might seem counter-intuitive to a welfare practitioner, but to an institutionalist it would come as no surprise (see, for example, Robinson 2001:ch. 3). Financial intermediation was strongly supported. Small but variable (as to size, term, purpose and availability) loans were seen to be a later need. Revolving credit schemes after the Grameen model had a very low priority. (This process, and the priorities, closely parallel those described in Kopunye et al. 1999 and suggest that there might be similar patterns across Melanesia, or at least across Papua New Guinea.)

Clearly, people attached importance to having 'a safe place to keep their money'. In Bougainville, the crisis would have exacerbated this. For nearly ten years, most of the people were unable to reach Bougainville's sole financial institution: the PNG Banking Corporation sub-branch in Buka. All other forms of financial institution (except one credit union dating from the 1950s) had become extinct before or early in the crisis. Money was hoarded in secret places. As soon as the BMFS appeared in pilot areas, deposits flowed in.

Finally, it was decided that the system should be owned by the people themselves and embedded in their communities. Communities would deal with the problems of 'wantokism' and loan delinquency in their own ways, each according to custom at their own levels. The issues surrounding adapting 'custom' to external financial technologies were discussed in depth. The 'system' should eventually be open to all people of Bougainville, without exception. There should be a central peak agency, *Haus moni bilong ol manmeri long Bogenvil* or BHM, owned by the grassroots but created to support the development of the system.

Building the BMFS system

BMFS was faced with a number of huge problems, all of which dictated that it was wise to proceed on a pilot basis and *go isi!* Although the war was not over, it was already clear that all infrastructure and human support systems, including roads, transport, communications, power generation, schools and hospitals, had been destroyed. Much of the population had been living in the bush for years and most were deeply traumatised.

Community services needed to be restored. Reaching remote people with financial services and providing a kind of capacity-building support would be extremely difficult. Even when normality was restored, remoteness, dispersed populations and lack of communications remained problematic. Economic activity needed to be rebuilt and access to markets restored. Economic activity would also need to be extended to the grassroots, supported by financial services. Alongside financial services, other skills needed to be co-developed, including literacy and numeracy, community governance and management, vocational and microenterprise skills. In the early days it looked as if BMFS would have to provide many of these skills. Later on, cooperation with other agencies became more possible.

The solution was thought to lie in a three-tiered structure. First, development should begin at the grassroots in the four selected areas: Siwai and Bana in the south, Central and Nissan Island, and atolls to the extreme north. At the same time Bougainville Haus Moni should start up. A coordinator was appointed. Technical experts held train-the-trainer workshops for grassroots leadership in basic financial skills, awareness building, enterprise management, governance and policy development, supervision, loans management and financial planning. As the conflict was not over, most of these workshops were held in Buka. Given the distances and the dangers, it was difficult for women to attend (see Byford and Guanara's article in this issue).

Finally, 'district' presences were created – an intermediate tier. BHM district coordinators were recruited and trained in the four districts in which the pilot areas were situated. They began to bring training and supervision closer to the grassroots and wider awareness building became possible. This greater awareness, however, led in turn to an increasing clamour for extension of BMFS services beyond the original areas. Demand grew in those districts where, in the early stages, no services had started up at all. From the opposite direction, the Bougainville administration, which was providing increased counterpart funding, was also keen to see services spread as widely and as quickly as possible. It was clear that, as Bougainville emerged from the crisis, microfinance services were in high demand. In technical terms, BMFS was being asked to provide both wide and deep outreach very quickly indeed. The difficulty was that the more BMFS responded to such demands, the greater the risk of system failure.

By early 2000 (the real end of Phase 1 on the ground), there were 24 MFIs reaching nearly 4,000 people, with almost K100,000 in savings but only K4,000 out in loans.

Competition and related 'problems'

The major ongoing 'competition' for BMFS is a branch of Village Finance, in Tinputz District on the northeast cost of the main island. Village Finance, which operates nationally, started as a subsidiary of PNG Banking Corporation, the government commercial bank which has recently been privatised. In Tinputz it provides a reasonable range of credit and deposit services and has quite strong community support. It presents no threat to BMFS, or vice versa.

In 1999 a number of pyramid money schemes appeared in Bougainville (and in the Solomons and in Papua New Guinea). About 45 per cent of deposits were withdrawn from BMFS and reinvested in these fast money schemes, only to be lost. It says much for BMFS members that the shortfall was restored within a year. BMFS members learnt a lot from this experience.

The existing welfare-oriented revolving loan schemes represent no direct challenge, as they have little breadth of outreach. The largest of them, a European Union scheme, has lent out about K100,000 in K500 lots. It is said that a Division of Commerce assessment of this scheme estimated that up to 93 per cent of its loans are delinquent. The scheme is no longer revolving. It is not clear whether the EU will repeat this experience.

BMFS – now and future

As W.W. Rostow might say, BMFS has now achieved lift-off. The guarantee of further funding for three years will see the system well advanced towards operational sustainability, with little or no need for expatriate technical input.

There is now a staff of seven in the Buka central office of BHM. Coordinators have been found for all eight districts, and all are growing rapidly, as Table 1 shows. Note that the fall-off in deposits in the last quarter of 2000 was combination of a write-off of unrecoverable pyramid scheme deposits plus withdrawals of Christmas club savings.

The rapid increase in membership and numbers of MFIs indicates a growth in breadth of outreach, especially into new districts where initial savings are small. That said, there is still a long way to go before all rural people are reached.

Table 1 Bougainville microfinance: Some performance indicators, 2000–01

	Sep. '00	*Dec. '00*	*Mar '01*	*June '01*	*Sep. '01*	*% increase*
No. of MFIs	42	58	76	112	136	224
No. of members	5,827	6,551	7,021	9,425	10,997	89
Savings (Kina)[a]	149,600	116,658	126,615	167,006	252,254	69
Loans (Kina)	15,696	32,629	37,427	62,223	97,782	523
No. of loans	n.a.	99	248	521	n.a.	[b]426
Av. loan granted (Kina)	n.a.	330	151	119	n.a.	[b]–64
Loans as % of savings[c]	10.5%	28.0%	29.6%	37.3%	38.76%	

[a] K1.00 = A$0.60 approx.
[b] For six-month period: December 2000 to June 2001.
[c] Target = 80% approx.

BMFS can also claim depth of outreach. Average savings per member are small (about K23), but this includes members of women's and children's savings clubs as well as more conventional deposits. Loans are increasingly reaching the grassroots, as the average size fell over the year to 1 June 2001 from K330 to K119. The stated purposes of recent loans are now being analysed, but anecdotal reporting from the districts suggests that more and more are being used for income-generating enterprises as well as for household purposes such as school fees and home improvements. Delinquency is yet to be reported, but the currently agreed practice in any case is to secure a loan against a member's savings.

As the Bougainville economy grows, new markets will open and new businesses emerge. Upstream and downstream linkages will develop and there can be increased economic activity from grassroots up. As this happens, BHM district offices will be transformed into cooperative financial institutions, providing a full range of essential financial intermediary services while supporting their smaller, grassroots MFI members.

All MFIs already agree that the system as a whole, and they individually, must move towards sustainability. This means setting interest rates that recover all costs, including the costs of training and inflation. Structural sustainability will also be achieved through insistence on good governance, through member elected boards and regulatory compliance at all levels.

To date, only a small fraction of donor funds (less than 3 per cent) have gone to meet the operational expenses of grassroots MFIs. Funds have been directed instead to system capacity building, especially the training of leadership and voluntary staff. While a provision has been made in the AusAID Phase 2 budget for some loan seed moneys, the ratio of loans to deposits is still low. It will therefore be a long time before any external borrowings might be necessary. By the time they are needed, it is possible that the system will qualify for commercial-rate loans from the new Asian Development Bank PNG microfinance fund which opens in 2002.

Meanwhile, there are some very human matters with special poignancy in post-crisis Bougainville that BMFS will need to focus on (adapted from Robinson 2001:105):

- Do grassroots people understand microfinance products and services and do they know how to use them?
- Can microfinance help economically active grassroots people expand and diversify their enterprises and increase their incomes?
- Can access to financial services enhance the quality of life of clients of MFIs?
- Can access to MFIs help economically active grassroots people in times of severe household difficulty?
- Can successful MFIs promote the self-confidence of their clients?

So far, times have been bad but the record has been good.

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Gender and microfinance in Bougainville: A case study

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This article describes our experiences of raising gender awareness among participants in the Bougainville Microfinance Scheme (BMFS) in its initial stages of development. Several articles in this volume discuss aspects of gender and microfinance and provide a solid context for our experience.

The project

BMFS was initiated by a cross-section of Bougainvillians in recognition of the need to encourage self-reliance and financial independence. Newsom (this issue) describes the background and development of the project; our focus is the gender and development (GAD) component.

GAD seeks to promote equal opportunities for women and men as participants in and beneficiaries of development. The BMFS is funded by AusAID. For all AusAID-funded projects there are certain contractual obligations that the Australian managing contractor must fulfil in relation to GAD. Organisations awarded projects often find it challenging to understand or acknowledge the relevance of GAD issues, let alone determine how they will meet their obligations. While GAD issues must be included in the project design, that does not necessarily mean they will be taken seriously or included in any coherent way in the implementation phase. However, BMFS project design was informed by GAD issues and there is a strong commitment by the Australian managing contractor (in this case, Australian Volunteers International and Credit Union Foundation Australia) and the Bougainvillian team to implement this component of the project.

The first gender workshop

Our first activity was to run a province-wide gender workshop in Buka to promote women's understanding of BMFS, to review their potential role and elucidate factors constraining their participation, to promote men's understanding of women's expectations and roles in Bougainville Haus Moni (BHM, the central federated body of BMFS), and to develop specific recommendations on gender-inclusiveness and gender-sensitive strategies. The appointment of the gender development officer prior to the workshop ensured the attendance of participants from most districts and from different social, religious and political groups and also ensured that women, the target of the workshop, were well represented, being 24 of the 35 participants.

For many of the young women, this was the first time they had attended a workshop, left their districts to attend a provincial activity, experienced being in a large group where both women and men were participating, and spoken publicly in such a forum. For most of the men, being in a workshop where the majority of participants were women was a new experience, and this was the first gender workshop they had attended. Some men found it challenging not to be in control of the process. They did, however, adjust very well and all participants worked together in a spirit of partnership and cooperation. This in itself is noteworthy in a post-conflict situation where participants were from different political alliances and perhaps reflects their commitment to reconciliation and a desire to build a 'new Bougainville'. (Bougainvillians frequently speak of the 'new Bougainville', a term that encapsulates their vision for the future. After ten years of civil conflict, they see this as a particular moment in the history of their island when they have an opportunity to create a more just and equitable society based on peace and reconciliation.)

The interest and relevance of BMFS to the lives of women in Bougainville were evident. The women enthusiastically participated and made strong recommendations on governance and strategies for their involvement in BHM.

Objectives and achievements of the workshop

Objective 1: To promote women's understanding of BMFS services, strategies, activities and opportunities, and to clarify their expectations

The women's understanding of BMFS was achieved in many ways throughout the three-day workshop. The participating women had very different experiences of money and money management, ranging from those who had never heard of microfinance to those who were involved in the operation of grassroots microfinance institutions (GMFIs). It was therefore important, after a brief introduction to BMFS, to hold small-group discussions about the role of money in their lives and in the broader community. This approach made it possible to develop and discuss various aspects of money management, especially how women currently earn money and how they use it, and whether they have control of what they earn. There were several plenary sessions dedicated to BHM and many opportunities for the women to clarify and revise issues. Both men and women became so engaged that discussions continued informally in the evenings at the different venues where the participants were staying. At each venue there were people with a good understanding of BHM and this informal forum was well utilised by all participants.

Objective 2: To review women's potential role in BHM and the factors constraining their participation

For many women this was their first introduction to the concept of microfinance and BHM. Considerable time was needed to explain both microfinance and this particular project. By the final day all were readily engaging in discussions about their potential role and identifying some of the factors constraining their participation. Women and men worked in separate groups and then came together to discuss the changing roles of women in Bougainville and the need for them to be actively involved in this project. Both men and women agreed that many men were now more supportive of women's involvement in such projects and that men would need to continue to support women in the 'new Bougainville'.

Several constraints to participation were identified. Many related to the gendered division of labour that found women responsible for the day-to-day care of their families and communities. Along with constraints at an individual and household level, participants identified those imposed on women by the wider society. Travelling around Bougainville continues to be challenging. Apart from a general lack of transport, fears for their safety from armed or drunken men, or from husbands who disapprove of their activities, are major constraints to women's participation in any activities at district and provincial level.

Although many women were actively involved in church and other activities outside their immediate families, both men and women acknowledged the need for women to be engaged in broader community affairs within the village and also at district and provincial levels. The reluctance of many women to take on these roles needs to be understood in relation to the mass destruction and displacement during the past ten years of conflict. Women's current priorities are to re-establish family and community life and many feel the need to live and work within their communities. Thus, they are reluctant to participate in activities that take them away from the village and their work on peace and reconciliation. For some women there are also problems flowing from the lack of formal education during the years of armed conflict.

Objective 3: To promote men's understanding of women's expectations and roles in BHM

Men's understanding of women's expectations was facilitated as the women became more familiar with BHM and were able to discuss the sorts of financial services they wanted, why they wanted them and how they wanted to use them. On the final day the women discussed their potential roles in BHM and the men responded very positively to their proposals. The men's commitment to work in partnership with the women was evident in their ability to identify the constraints to women's participation and to develop strategies to support that participation. The support of the men was crucial to the women's attendance at the workshop. The men (participants and staff of BHM) actively sought the women's participation at district and grassroots levels and then accompanied them to Buka and home again.

Objective 4: To develop specific recommendations on gender-inclusiveness and gender-sensitive strategies for all activities and stages of BMFS developments

A number of recommendations and strategies were developed on the last day of the workshop. The recommendations were that:

- women, in equal partnership with men, are involved at all levels of BHM;
- women are involved in equal numbers with men at all levels of BHM, particularly at the district and provincial level;
- men support women's involvement;
- women are targeted for training in all areas concerned with BHM;
- there is effective communication within BHM and with other key women's groups;
- women are involved in all decision making; and
- women are involved in policy development.

The strategies were to:

- make training available at district and grassroots levels to women and men;
- provide follow-up support at all levels after training, particularly at grassroots level;
- provide transport to allow women to participate;
- conduct awareness sessions on microfinance and gender issues at grassroots level for women, men and chiefs;
- ensure that enough women are trained at the grassroots level so that, as they become involved at district level, there are still women with the knowledge, experience and skills to maintain the grassroots level;
- continue to invite women to participate in BHM activities;
- BHM to continue to be pro-active in recruiting women at all levels;
- incorporate gender awareness in all activities and at all levels;
- ensure that capacity building includes bookkeeping, budgeting, general management and time management, policy making and setting of objectives;
- allow for women-only sessions and training, facilitated by women for women; and
- allow for women-only groups in workshops or training where both men and women are present.

The recommendations were presented to and accepted by a workshop on the governance of BHM held in the following week. Together with the strategies identified in the first workshop they have provided the basis for further activities in relation to the gender component of the project.

Continuing workshops

Two further three-day gender workshops were facilitated at district level. They involved one day for microfinance issues, one for gender awareness issues, and one for bringing both issues together.

The workshops allowed concepts relating to gender, such as gender roles and gender equality to be introduced, defined and discussed. Many people, in Australia as well as in Bougainville, equate the word 'gender' with women, so it was important that everyone was clear about the terms. The gender awareness day included a series of interactive participatory exercises that gave people a picture of how their communities work, particularly in relation to the gendered division of labour, the use and control of money, resource management, decision making, and positions of authority and leadership. Recognising that the roles of individual men and women may differ, we sought to establish who was generally responsible for the various roles. In all three workshops these activities revealed that women:

- are responsible for the majority of subsistence work;
- are mostly responsible for care of children;
- tend to the needs of sick people in the family and community;
- work longer hours than men;
- participate in decision making in the family and nearby community;
- have some control over money in family and nearby community;
- manage money for the family;
- occupy important positions in the community, mostly unpaid;
- occupy positions that pay low salaries; and
- are under-represented in positions at district and provincial levels.

Men were found to:

- have less responsibility for child care;
- have less involvement in caring for sick people;
- work substantially fewer hours than women on subsistence activities;
- make decisions at the district and community level;
- control money at the district and provincial level;
- spend money on themselves rather than on their families;
- occupy most of the important positions in the community, mostly paid;
- occupy positions that pay high salaries than those occupied by women; and
- be over-represented in positions at district and provincial levels.

This information is then used as a basis for discussion, often prompted by questions such as: Does this seem to be a fair and desirable way to divide the roles between men and women? Does this work well for men and women the way it is? Are you happy with your role as a man or woman in this place? Would you like it to be different?

Participants are invited to suggest how this situation could be changed, if gender equality is an important goal for them. These are some of the comments and suggestions arising from these discussions:

> Community and family support is not strong enough; people need to change their attitude, especially the men, in order for women to come up.
>
> Lots of customary obligations for women, even when women are educated they do not have enough spare time for additional projects as they are involved in a lot of work for the family and community already.
>
> Women must lose some shyness and try and get positions [of authority at community, district and provincial level] and men should try and get women into these positions.
>
> We must encourage girls and women to further their education.
>
> We need to educate children, boys and girls, to work together on an equal basis.
>
> Parents need to encourage children to develop gender roles on an equal basis.

Presenting the participants with some data about the overall status of women in the world – for example, that of 1.3 billion people living in poverty, 70 per cent are women, 50 per cent more women than men are unable to read, adult women suffer more than men do from malnutrition, women's wages are 30–40 per cent less than those of men who are doing comparable work – allowed them to see that the situation for women in Bougainville is not unique.

On the last day of the workshops participants were presented with gender disaggregated data (provided by them during the workshop) on their GMFIs and discussed various issues that arose from these profiles. This was related to the previous day's work on gender equity and decision making and the implication for the status of women in a society where men are over-represented in key decision making roles at all levels. We encouraged those involved in GMFIs to discuss these issues when they return to their communities and to consider what they might need to do to make their GMFI more gender responsive, sensitive and equitable – if these are what they are striving for.

Conclusion

The three workshops were extremely well attended and we have many requests to facilitate workshops in other areas of Bougainville. Since attending the workshops, women have mobilised, often in partnership with men, to conduct awareness sessions on gender and microfinance in their respective communities. The establishment of new GMFIs is the result of women's initiative. BMFS has grown in leaps and bounds and women are very active participants.

The importance of a local gender development officer (GDO) cannot be underestimated. The GDO's familiarity with the social, political and cultural context increases the probability that our work on the project will be appropriate and sensitive and have a greater chance of impacting positively on women's involvement in BMFS. The GDO is a focal point for women in the community, who frequently consult her. Her appointment and work on gender awareness signal to the Bougainvillian community BHM's commitment to facilitating women's participation and to gender equality.

From a gender and development perspective, one of the major challenges in this project is to meet women's strategic needs. The communities we have worked with have all identified gender inequality within their communities and have expressed their desire to move towards equity. The realisation of this desire implies some fundamental changes in governance and the way the society works. In the absence of strategies addressing issues of gender equity in the broader community at district and provincial levels, this will be hard to achieve.

Primarily, microfinance programmes respond to the need to provide access to financial services to people who would not otherwise have such access. Microfinance development programmes should therefore always be regarded as just one possible intervention within a range of others, particularly in relation to poverty alleviation and women's empowerment (Cornford 2001:17).

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Microfinance in the Pacific – *mipela katim bus!* The experience of Putim na Kisim

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Introduction

In the 25 years since Professor Muhammad Yunus' private experiment with what is now the Grameen Bank, hundreds of Grameen replicators have evolved throughout Asia, Africa and other parts of the world. Although Papua New Guinea has a history of savings and loans societies, 'microfinance is a relatively new concept in Pacific Island Countries' (McGuire 1996:29). There are therefore mixed opinions as to the potential of the Grameen Bank system for success in the Pacific region. Bablis (1999:19) suggests that the Liklik Dinau Abitore Trust was using the Grameen Bank approach and that this can be a standard for other microfinance institutions (MFIs) in the region. McGuire (1996:28) suggests that where the Grameen system is chosen, its structure be followed closely. By contrast, economic anthropologist Gregory (1998, 1999) and microfinance specialist Hickson (1997) argue that the culture, geography, economy and target group of microfinance are fundamentally different in Papua New Guinea, making the Grameen approach unworkable.[1] The recent demise of Liklik Dinau adds credibility to their view.

Gregory's argument is based on the analysis of how the indigenous economy of Papua New Guinea (and other Pacific nations) is different from rice-producing countries where the Grameen Bank and its replicators have been most successful. He provides a useful comparison of rice economies and root-crop economies such as Papua New Guinea. In particular, he highlights the fact that, in Papua New Guinea, food is produced for subsistence, rather than trade, since root crops *bagarap hariap* – they cannot be stored as can rice. Villagers in Papua New Guinea therefore experience 'subsistence affluence', where poverty is due to lack of health and education services, rather than to hunger.[2] This combined with the fact that, unlike rice, root crops cannot be stored and sold has meant the indigenous economy of 'PNG had none of the periodic marketing systems indigenous to rice cultures' (Gregory 1998:8).

Colonialism therefore brought what Gregory calls 'stalactite dollar capitalism', rather than the 'penny capitalist' or 'penny finance-led development' found in indigenous Asian economies (1998:8). The term 'penny capitalism' was first used in 1953 to describe indigenous economies in which there is land tenure over tiny plots of land, where farmers produce crop surplus and engage in small-scale trading. Microfinance evolved in penny capitalist economies. Gregory (1998:7) argues that Papua New Guinea has 'dollar capitalism', since clans have customary land ownership over large areas of land; food production is for subsistence, with larger amounts of money then generated from cash crops, with the result that there is not the proliferation of small markets and petty trading.

This article begins with the acceptance and support of his argument that any microfinance system developed in Papua New Guinea should start with the basis of the economic culture and be developed by the rural people who are the experts on root-crop farming (Gregory 1998:12, 15).

In response, this article outlines the microfinance system evolved by Putim na Kisim, a network of rural savings and loans cells operating under the auspices of the Lutheran Development Service of the Evangelical Lutheran Church of Papua New Guinea. The structure and systems have come from the village level through a process of experimentation and dialogue and are therefore unique to the culture, economy and diversity of Papua New Guinea. In this way, the people themselves discuss what it means to save money and to give loans in their economic culture and, together with Putim na Kisim trainers, develop systems which utilise the wisdom of indigenous forms of savings and loans. This article therefore demonstrates how Putim na Kisim has utilised the thinking behind the Grameen Bank, but with a strategy which is relevant to the root-crop economy of Papua New Guinea.[3]

The experience of Putim na Kisim members

Putim na Kisim operates in five PNG provinces, with membership based around traditional forms of social organisation (clan) or at the church parish level. There are currently 1,200 members (some 'members' are groups, such as the Women's Association, so in fact this number represents 3,600 individuals). A further 1,000 members will join next year and another 2,000 in 2003. The demand for Putim na Kisim groups is much higher than this, but growth is kept steady due to available funds and staff capacity.

During village-based workshops, Putim na Kisim has documented the insights of participants into their need for savings, loans and how to organise a system for meeting these needs in their own community.

Savings needs

The findings of Putim na Kisim support the observations by Hickson (1997:3) that 'capital is not that scarce' and Gregory (1998) that the PNG economy is a form of dollar capitalism, rather than the penny capitalism found in rice-growing countries. Rather than scratching for every *toea* to invest on a weekly basis, income is 'lumpy' and irregular. Thus, income will be received upon sale of the coffee harvest, potato crop, copra, cocoa or *buai* (betelnut). In addition, people only put their time into money-making activities when there is a need for money – when school fees are due, a child is sick, or bride-price needs to be paid.

Hence, most Putim na Kisim members say that they can get some money, but it is not regular and they have many family and community obligations attendant upon this money.[4] To survive in an economy based around staples which cannot be stored, villagers say they have learnt not to store anything, but to use it as it comes. As villagers reflected at one workshop, *pasin bilong sevim moni, ino stap long blud* – 'the habit of saving money isn't in our blood'.

Cell members are keen to use Putim na Kisim to enable them to develop a savings culture as a community. As one group described it: 'When we've sold our coffee, there is plenty of money for *buai*, we can buy whatever we need and everyone is really happy. After three months the money is all gone and we spend the next nine months with our head hanging down feeling depressed because there is no *buai*.'

In addition, members of a Putim na Kisim group in the Western Highlands said they need savings services so they can protect their money from the frequent obligation to donate to competitive feasting, compensation or other events (Hickson 1997:3, Rynkiewich 2000:2–4).

Loan needs

Papua New Guinea's rural population has land and access to the *wantok* system, which provides a traditional form of savings and loans. However, because of the irregularity of income, loans are needed for income smoothing and to start small businesses to pay for items now required by the capitalist economy, such as transport, school fees and medical expenses. The potato farmer has to pay his children's school fees in January, even though he cannot harvest until September. In one Putim na Kisim group, loans are given to coffee buyers who can then obtain a better bulk price for the growers and reduce transport costs. With others in the community reliant on the same crop cycle and with the same expenditure needs, the traditional system of pooling money in a time of need and repaying later is not as effective.[5] Loans over three to nine months enable borrowers to make these purchases until they are able to redeem their crops.

It is difficult to ascertain the extent of the need for cash. A family with five children may have to pay K2,000 (A$1,300) per year for school fees, consuming most of their income. Declining commodity prices have left most farmers reflecting that they can no longer afford the fertiliser, seedlings, transport and other costs associated with their business. On the other hand, some church leaders are critical of people's cash demands and reflect that cash-crop income is often spent on beer, store food and paying labourers and has not led to an increase in the standard of living.

Because income is irregular, it is not possible for Putim na Kisim members to save money or repay loans in even instalments. Loans are often repaid at an agreed-upon time, usually when farmers' cash crops are ready to be sold, with occasional instalments made prior to this as money trickles in from market sales. Thus, weekly meetings to collect savings and loan repayments are simply not possible in Putim na Kisim. So, too, the Grameen system of group pressure at weekly meetings through public knowledge of loan defaults and timely reminders of overdue payments is not possible (Morshed 1997:1–8).

To find systems which will work in the economic context of Papua New Guinea, trainers discuss with members systems of savings and loans from their own traditions (*pasin bilong tumbuna*), explaining that the Putim na Kisim group they develop must evolve from this valuable experience.

Traditional forms of savings and loans in Putim na Kisim groups

By building on traditional methods of exchange, Putim na Kisim is able to develop an effective localised system. The first case study is taken from a Putim na Kisim group in the remote mountains of Morobe province, in a village which is only accessible by light aircraft. To explain how money used to be saved and loaned, people described the system used to pay bride-price.

A key principle is that everyone gives, even if they are not yet married. For them, it is an investment in the future, knowing that when they need to pay bride-price, others will help them. Hence, there is a history of putting money in first and receiving it much later – an unusual contrast to root crops which must be consumed soon after harvesting.[6] This information is developed by trainers to demonstrate the Putim na Kisim system: putting in first and taking out (*kisim*) afterwards.

Further, contributions to bride-price are only made to one's own relatives, hence the money is circulated among a small group of individuals who are interdependent. Villagers later decided that the group responsible for contributing to bride-price was often the most effective level at which to start a Putim na Kisim savings cell, since the obligations are strongest.

Finally, the amount received in return is commensurate with that given. As one person put it, one wouldn't expect to give a *bilum* (string bag) and then receive a pig, although perhaps a slightly larger pig, in return. Putim na Kisim trainers use this to explain the relationship between savings and loans in Putim na Kisim, in contrast to money rain schemes in which it is claimed the investment will be disproportionately multiplied as in a typical pyramid scheme.

A second example is from Putim na Kisim groups in the Western Highlands. The specific name for traditional exchanges is the *moka*, where all the villagers must put in money, pigs and food to help the *bikman* (important leader) pay for competitive ceremonies, shows of wealth or other important events. The *bikman* is then pressured by the people to negotiate with the *hetman* of the rival clan, who will in turn put pressure on his people to contribute for a reciprocal feast. Villagers report that problems have arisen when the *bikman* becomes consumed with the need for increased status and so the pressure for contributions increases, but with little return for them.

Examining the workings of these ceremonies enabled participants to identify that the three clans involved in the *moka* would form the basis of the Putim na Kisim group. To incorporate the traditional system of leadership, the members decided that the village *hetman* should be a member of the loans committee, with particular responsibility to follow up people who have not repaid their loan on time. To overcome the problems experienced with *moka*, they agreed that responsibility for money management would be shared between Putim na Kisim members, with democratic decision making and open accountability.

The microfinance system developed by Putim na Kisim members

Group formation

Putim na Kisim trainers asked members about the value of forming small savings cells within the village, such as pioneered by Grameen. Members in all Putim na Kisim groups have resolved that there are no natural forming communities of five members, rendering a small group system artificial and cutting across strong clan allegiance.[7]

Instead, they have decided that savings cells must form around the existing clan structure and build upon community relationships. Villagers identify this group as the people who they have singsings with, help to pay bride-price and compensation, support during clan conflicts and intermarry with, and where they have the local church. To this group they have the most loyalty, since their survival in so many other areas depends upon both the continuation of that group and their acceptance into it. Strong relationships are therefore foundational to a village-based savings cell.

Thus, although Putim na Kisim groups do not have frequent official meetings, members of a Putim na Kisim cell form part of a social grouping which is integral to every aspect of their lives and considerable informal time goes into the maintenance of these good relations.

Each Putim na Kisim group elects their own management, loans and other committees. They write their own policies and guidelines to suit the local situation, make their own decisions about granting loans, and collect and account for savings and loan repayments. Since loans come out of their own accumulated savings, rather than from external grants, people have a vested interest in the success of their Putim na Kisim group. Lutheran Development Service provides extensive member training and on-going support for cell groups.

Loan disbursement

Members of this social grouping interact almost daily and have known each other's families for generations. Group members are therefore well able to make decisions about granting loans and obtaining repayments. Integral to the requirement to know the borrower is to test their ability to repay loans. The people say that even a great and honest leader may not have had sufficient contact with the money economy to know how to save money and repay loans.

The borrower must first deposit a small amount and then a small loan can be issued. As more money is deposited, larger loans can be issued, but initially limited to the value of the savings. In this way, people are giving themselves the space to engage in a gradual learning process of interacting with the money economy. Only when the borrower has shown a good track record of repayment will loans be granted in excess of the value of savings.

Putim na Kisim members' response to the Grameen system of group liability has been resoundingly negative. It is seen as unnecessary, since the *wantok* system would ensure that defaulting borrowers who had done everything in their power to repay would be assisted. However, members are not willing to write this into the *stia tok* (policies) and make it compulsory, in case borrowers misuse the clause and abrogate their responsibilities.

Leadership

Putim na Kisim members reflect that their *tumbuna pasin* (traditional system) organised the village around a headman who gave responsibility for various specialty tasks to those so equipped. In the Western Highlands, for instance, villagers report that there can be a *bikman* for relating to outsiders (someone with good English), someone else who is in charge of giving public speeches, another respected for his religious knowledge, another for traditional medicine, and so on.

In Putim na Kisim, therefore, a village leader may oversee the process but will delegate responsibility for organising and undertaking the work to others with the skills and respect of the villagers. In all workshops, people confirmed that when responsibility for money is given to one person, *em save bagarap*. As such, Putim na Kisim members have agreed that decision making and responsibility for money have to be held by the members, with the treasurer's role shared by a finance committee. Through various working committees, every member has some role to play and this adds to their commitment to the success of the scheme.

The successes have occurred where the village leaders use their power and knowledge to encourage the education of members and to guide and support the savings cells. There will be failures, however, if Putim na Kisim becomes a tool for traditional or institutional politics and a means of adding to personal power and prestige. In this scenario, the operations of a Putim na Kisim group could be controlled by a small elite who make money and business part of secret knowledge and both the power structure and overriding need to maintain harmony could render others powerless to confront it.

Discussion

In identifying these systems, Putim na Kisim members say *mipela kutim bus* – 'we are pioneers cutting our own way in the bush'.

Putim na Kisim is enabling people at the grassroots to find their own way of saving money and giving loans.

The wisdom of Putim na Kisim members is in finding the unit of society where the strength of obligations is such that people risk being excluded from the community if they are seen to upset the lives and harmony of others. By building a Putim na Kisim group among the same people who together will pay compensation and bride-price, fight as a clan, celebrate and worship, their obligation is as strong as to a clan member.

Putim na Kisim is therefore evolving a system of microfinance which is appropriate to the unique culture and economy of Papua New Guinea. It is not a Grameen replicator, but its underlying thinking draws upon the strengths of the Grameen system.

Notes

1. In particular, Gregory (1998:15) argues that 'the Grameen Bank model of microcredit is not a solution to Papua New Guinea's problems, but, rather, yet another problem'.
2. Putim na Kisim members in fact argue that they should not be referred to as 'poor', since they have land and food, and that the term 'people without money' is more appropriate.
3. Based on Gregory's statement (1998:12) that 'what needs to be replicated is the thinking behind the development of the Grameen Bank in Bangladesh, not the institution itself'. See Newsom (1999) for a fuller explanation of the history of Putim na Kisim.
4. The emphasis is upon 'most' but not 'all'. For instance, in some villages, women do not have access to money because all the proceeds from cash crops go to men and often widows who have no land of their own only make money from the sale of garden produce.
5. For instance, in coffee-growing areas, everyone harvests in the same season and so they have money at the same time. But everyone's school fees are due in January, with the result that everyone also needs money at the same time.
6. The exceptions are some types of tapioca, taro and yam, which can be left in the ground for some years.
7. According to Rynkiewich (2000:2), Papua New Guinea was traditionally organised into small units of society, with 'people's primary affiliation . . . to lineage, clan, co-residents, affines, allies and trade partners'.

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Location and microenterprise performance: Evidence from Sri Lanka

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Introduction

This article is based on the findings of a PhD study which investigated the impact of loans on the incomes of participants in two NGO-led microcredit programmes in rural Sri Lanka: Women's Development Federation and Sarvodaya Economic Enterprise Development Services. ∓The principal research instrument was a socioeconomic survey of 253 borrower households, supported by focus group discussions and in-depth interviews with participants and NGO staff. A key objective was to identify the underlying causes of the well-documented microcredit 'impact gap', in which less-poor borrowers – those above and around national poverty lines – have been found to be more likely than the extreme poor to participate in credit programmes and to receive greater benefits from them (Hulme and Mosley 1996, Wood and Sharif 1997).

For poorer borrowers, economic, social and human capital constraints impose formidable barriers to microenterprise development. Poverty itself is a deterrent to productive investment, creating pressures to allocate scarce funds to consumption. It leads borrowers to reduce their exposure to risk by taking small loans and forgoing fixed capital investments, which produce higher delayed returns, in favour of low-risk working capital investments which generate meagre but immediate cash flows. Even with microcredit loans the poor cannot finance the high capital requirements of the highest-earning enterprises, which often exceed the NGOs' group-based lending limits and are therefore restricted to less-poor borrowers with additional investment funds. Many lack the technical and business skills required for higher-value microenterprises, and their mobility and productivity are limited by poor health, undernutrition and a household-level shortage of able-bodied adults. They are further disadvantaged by low social status, behavioural norms which discourage individualism and upward mobility, and by a gender-based division of labour which reserves most higher-valued occupations for men (a significant problem for female-headed households, which were among the poorest in the sample).

The most important of the many problems faced by poorer borrowers, however, is their lack of access to the physical resources which support profitable microenterprises. The main focus of this article is on the critical role of location as a determinant of microenterprise performance. Most studies which examine the impact of location on microenterprises find significant location-based performance differentials, particularly between urban and rural activities. Urban microenterprises earn higher incomes than their rural counterparts, operate in conditions of stronger effective demand (Barnes et al. 1998), have superior access to inputs, infrastructure and business information (Snodgrass 1996), grow more rapidly, are far more likely to survive their first year and have lower closure rates (Liedholm and Mead 1999). As the poor are concentrated in the most remote and resource-deficient regions, location-related variables are an important contributor to the microcredit impact gap.

The role of location in microenterprise performance

Hambantota district, where the research was conducted, is a remote area in Sri Lanka's southeast. It is one of the country's poorer regions, ranking thirteenth in per capita GDP of the seventeen districts outside the northeastern war zones (UNDP 1998). It contains no large urban centres, but has five or six regional towns with populations ranging between 5,000 and 15,000. About a quarter of the district's inhabitants are urban or semi-urban, living in and around the towns or close to the densely populated arterial road which follows the southern coastline. The key location-related characteristics of the sample households are described in Table 1.

Few borrowers rely solely on their microenterprises. In most households, the loan-assisted microenterprise is one of a number of income sources. The composition of household economic portfolios varies between locations. Incomes from semi-subsistence paddy-farming, the principal occupation of two-thirds of Hambantota's population, are in long-term decline due to growing pressure on land and water resources, policy reforms which have reduced the value of input subsidies and exposed farmers to competition from imports, and falling world prices, and most farm incomes are well below the poverty line. Nevertheless, access to subsistence food production provides farmers with a major advantage over landless rural and semi-urban poor households, which lack basic food security, having neither the means to grow food nor the purchasing power to meet minimum food requirements. Landless rural fishing households, concentrated around the difficult-to-reach coastal lagoons where the land is too salty for either agriculture or the grazing of cattle or goats, were the poorest group in the sample.

The role of infrastructure

The key location-related determinants of microenterprise performance are the quality of physical infrastructure, and the

Table 1 Key socioeconomic and microenterprise characteristics of sample

Location	*Definition*	*Median micro-enterprise income (rupees/ month)*	*Median household income (rupees/ month)*	*Households below poverty line (%)**	*Major microenterprise occupations*
Urban	Households within 1 km of town centres in regional towns with populations of 10,000 or more, or on main coastal road.	4,000	8,875	15.3	Specialised retail trade, services, skilled manual production.
Semi-urban	Households 1–5 km from regional town centres or up to 1 km from coastal road.	3,000	6,850	31.8	Inner suburbs: skilled and unskilled production, petty retail trade. Outer settlements: brick-making, other low-value unskilled production, fishing, small-scale livestock-rearing.
Rural	Households more than 1 km from coastal road or more than 5 km from a town centre.	2,000	4,550	56.8	Paddy cultivation, fishing, small-scale livestock-rearing, unskilled production.
Whole of sample		3,000	6,250	36.4	

*The poverty line for a family of five, below which households are unable to meet survival-level food and non-food requirements, is Rs5,000 per month (about $US70).

level of effective demand for microenterprise products. Reliable power, communications, water and transport services facilitate technological innovation and better access to inputs, markets and information. They also increase productive capacity by reducing morbidity and improving access to health and education services, extending available working hours through electric lighting and labour-saving household appliances, and reducing unproductive time spent on such activities as collecting water and travel by foot. Sound infrastructure stimulates demand for microenterprise products by facilitating local employment-generating economic growth and providing rural workers with access to urban labour markets. In sparsely populated regions where local demand is weak, good transport services facilitate rural-to-urban market linkages.

There is little large or medium-scale manufacturing activity in Hambantota, which in comparison with Sri Lanka's densely populated and better-resourced western regions is an unattractive location for industrial investment because of its low population density and distance from ports and commercial centres. The main economic activities are smallholder farming and fishing. The non-farm sector, which is the principal income source for about a quarter of households, is dominated by micro-level firms employing between one and ten workers, in occupations ranging from the very low-value and unskilled (rock-breaking, mobile petty trade, backyard poultry-rearing, production of rope from coir fibre, production of lime from crushed seashells) to more highly skilled and highly capitalised activities which are capable of sustaining their owners well above the poverty line (carpentry, jewellery-making, motor repairs, food processing, barber-shops and established retail outlets in commercial areas). Because higher-value non-farm activities require reliable infrastructure and market access, most of the non-farm microenterprises, and all but a handful of the higher-value activities, are located in urban and semi-urban areas, while farming remains the main economic activity in rural areas, with a small number of marginal non-farm microenterprises.

The absence of electricity in many areas rules out many of the highest-value production activities, such as carpentry and mechanical repairs which use power tools. The more sophisticated technologies employed in food processing and packeting, coir-rope production and garment-making also require electricity and the few enterprises in these occupations without power are uncompetitive.

Local differences in population and income levels, and in the quality of transport infrastructure, create considerable disparities in market access. Urban enterprises have a densely populated and relatively prosperous customer base of local town-dwellers, and the towns are also commercial and administrative centres for outlying farming settlements. They support a variety of production and trade activities in food items, garments and other consumer goods, sales and servicing of agricultural equipment, and some wholesale trade in agricultural products. In addition, urban population growth has given rise to a vigorous housing construction industry, funded by subsidised government loans and remittances from migrant workers, generating high demand in the construction-related trades of carpentry and brick-making. The busy coastal road connects the district with the national capital, 250 km to the west, and is the main route for pilgrims travelling from Colombo to the pilgrimage centre of Kataragama to the east, and for foreign tourists visiting Yala national park. With the rapid expansion in vehicle ownership in Sri Lanka in the 1990s, motor repairs is a strongly growing occupation. Commercial activity along the road is dominated by motor repair workshops, curd producers and tea-shops servicing passing trucks, tourists and weekend bus-loads of pilgrims.

While the generally poor quality of Sri Lanka's road network is a significant problem, contributing to the reluctance of large-scale manufacturers to invest in the provinces, most urban and semi-urban microenterprises are on vehicular routes with bus services and have ready access to supplies and customers. However, for rural households, the effects of distance are aggravated by transport deficiencies, which constitute the single most important obstacle to microenterprise development. Many rural roads are nominally on bus routes, but in practice buses are infrequent and unreliable due to inadequate road maintenance and poor regulation of the privatised public transport industry.

As access to passing vehicle traffic and to customers from outlying areas diminishes considerably even a short distance from a town centre or the coastal road, these markets are virtually confined to urban enterprises, while semi-urban and rural producers rely principally on customers from their own neighbourhoods and on visiting traders. Some semi-urban borrowers make use of their access to public transport to engage in mobile trade, such as setting up stalls at regional markets. Market access is weakest among rural non-farm microenterprises, most of which rely entirely on local customer bases in regions where average population densities rarely exceed 100 per square kilometre. Such enterprises are limited to extremely low-value petty retail trade and fishing and livestock-rearing activities which combine subsistence production with trade in staple foodstuffs.

Rural, semi-urban and urban differences

Not all rural microenterprises rely on local customers. Farmers and producers in some low-income non-farm occupations, such as rock-breaking, lime production and coir-rope production, deal with visiting traders who purchase the finished products and in some cases supply raw materials as well. Rural producers are disadvantaged relative to their semi-urban competitors: as their remoteness increases the cost and difficulty of reaching them, fewer traders visit rural areas, and restrict their visits to the most remote regions to dry seasons when road access is possible, thereby limiting turnover and producers' bargaining power, and passing on the costs of travel to remote areas in the form of lower producer prices.

Given the importance of agriculture in the district economy, most non-farm enterprises experience crop-cycle-related fluctuations in demand. The impact of seasonality on demand is strongest among rural non-farm microenterprises, as their markets are composed principally of local farmers and agricultural labourers. Urban and semi-urban enterprises also experience surges in activity during post-harvest periods, but seasonal fluctuations are mitigated by their greater access to non-farm customers, and higher customer incomes which support demand even during lean seasons. Those least affected are urban and roadside microenterprises which draw their customers primarily from the local non-farm population and from passing non-local traffic.

While urban and semi-urban demand and production conditions support a diverse range of activities, many of which operate in growing or niche markets, rural microenterprises are concentrated in a narrow range of occupations. Low barriers to entry resulting from minimal skills and capital requirements, combined with the scarcity of alternative income-generating opportunities, create intense competition and market saturation with an over-supply of firms selling identical products in identical markets. In villages which could support perhaps a single tea-shop on a modest income, it is common to find three or four such enterprises, each with an identical, narrow product range consisting of rice, lentils and soft drinks, and each with earnings well below the poverty line. Overcrowding generates unsustainable competition: a number of tea-shop operators complained that, although their businesses were being harmed by the extension of credit to non-paying customers, their competitors offered goods on credit, so each operator was under extreme pressure to continue the practice or lose customers.

Conclusion

Evidence from the sample indicates that, with ready access to vigorous markets, raw materials and productivity-enhancing infrastructure, many microenterprises are capable of earning incomes which support their owners well above the poverty line. As their main constraint is often a shortage of capital, they generally respond strongly to loans. In terms of their potential to reduce poverty, skilled production activities such as mechanical repairs, food manufacturing and carpentry are among the most promising microenterprises. They have considerable growth potential, as they operate in growing markets with little competition from larger producers. They rely on human capital and incremental additions of technology rather than the large initial capital investments required by some other higher-value microenterprises, so they are financially accessible to poorer borrowers and responsive to the small-scale technical assistance and microcredit inputs which local NGOs have shown themselves to be very good at providing.

Such microenterprises are not viable propositions in remote rural areas, however. Because microcredit programmes have little influence on such key determinants of enterprise incomes as population densities, agricultural commodity prices and input costs, and the condition of roads, irrigation and power facilities, they offer little prospect of poverty-clearing income growth for borrowers whose enterprises are subject to severe constraints on demand and production.

A central paradox facing poverty reduction strategies based on microenterprise credit is that they tend to be least effective where they are most needed. Poverty in Sri Lanka is predominantly a rural phenomenon: in rural areas, where most people live, rates of poverty are well above the national average, and the rural poor are poorer than the urban poor. Poverty is often a direct consequence of location in remote and underdeveloped regions, where wage employment and other economic opportunities are scarce and unremunerative. It is precisely in these areas that microenterprise development strategies are least successful, as the deficiencies which discourage other forms of economic activity also restrict the scope for high-earning microenterprises. While there is an urgent need for an expansion of income-generating opportunities for rural households, microenterprise credit is unlikely to be an effective poverty reduction strategy unless supported by a substantial revival of public infrastructure investment aimed at improving the productivity and market access of rural microenterprises.

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Microcredit and poverty alleviation under post-socialism: the Oxfam-Community Aid Abroad experience

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Obstacles to microcredit in socialist Asia

In contrast to the widespread uptake of microcredit in South Asia, the extension of microcredit to the poor in China and the countries of the former Indochina bloc did not really begin until the early 1990s. There were several clear reasons for this:

- Governments of China, Cambodia, Laos and Viet Nam had a clear socialist mission and mandate for eradicating poverty and ensuring a basic decent living for even the most marginalised:.[±]
- The economic models on which this was predicated in each case assumed strong central control and planning of the economy, and positioned the state as the key redistributor of wealth.
- Independent market activity was curtailed, to varying degrees and for varying periods of time. As most microcredit schemes are predicated on beneficiaries producing goods or services for open sale, the conditions necessary for their operation did not exist.
- Money-lending was in bad political odour in several countries, particularly Cambodia, where it was traditionally the chief means for the urban middle classes to exploit the peasantry. Its reintroduction as a means of supposed poverty alleviation by non government parties would have been extremely suspect.

From the early 1990s, however, international NGOs and UN bodies began to introduce microcredit schemes in all four countries. There were several interrelated factors which made this possible, the most significant being:

- Some measure of free-market reform had taken place in each instance. *Doi moi* began in Viet Nam in 1986, relaxing state controls over retail commerce in particular, and small-scale production. In Laos, the New Economic Mechanism (NEM) began at the same time, on a parallel design. In Cambodia, state control over small-scale commerce and production had never been fully exerted since the fall of the Pol Pot regime in early 1979, and such controls as had been put in place were wound back gradually from 1986, and disintegrated in the early 1990s. Chinese state control of the economy was more thoroughgoing and deep-rooted, having begun in 1949; but macroeconomic reforms from 1978 began to be felt at village level from the introduction of the Household Responsibility system in the early 1980s, and by the early 1990s local private market activity was an entrenched reality in nearly all rural areas.
- The scope for activity by international NGOs (INGOs) widened considerably in the early 1990s. This was partly due to those INGOs which had established themselves early having gained a measure of trust from the host governments. This allowed them greater freedom to work directly in rural areas and with village populations, rather than under close and constant monitoring through central government bodies and their pre-ordained plans. In the former Indochina countries, it was also due to chronically under-resourced governments' incapacity to maintain control over the steadily increasing number of INGOs and their operations.[1] INGOs were probably the main channels through which different rural development models were introduced, and, as many had experience of microcredit in other countries, they saw the opportunity to use it.
- Official disapproval of credit at interest became increasingly a façade. Covert private lending had been a fact of life in Cambodia at least since the early 1980s, mostly at exorbitant rates. This was blatantly obvious by the early 1990s, when land had become (for the first time in Cambodia's history) a saleable commodity, and usury was once again a fact of life and a major factor in impoverishment. Similar conditions pertained in Viet Nam and Laos at the time, making governments receptive to the idea of credit managed by NGOs to alleviate poverty.

In the context of reversion to individual private household production, governments also introduced their own credit schemes: some with specific poverty alleviation design features; some with a specific social welfare focus (especially for veterans and their families); others mainstreamed agricultural credit banks in free-market conditions, complementing broad macroeconomic goals rather than poverty alleviation as an end in itself.

Some examples are given here of different schemes with which I have had contact in the last decade. These examples do not claim to give a comprehensive view of credit policy and trends in the countries concerned but may provide some indications of the impact which macro-policy trends have had in some areas of acute poverty.

China: Oxfam's credit programmes in Yunnan, Guizhou and Guangxi

In 1991, Oxfam Hong Kong began work with particularly impoverished communities in Yunnan and Guizhou provinces, in southwest China, initially in Luquan county (Yunnan) and Weining (Guizhou). This work has expanded to several more counties in both provinces, as well as to Guangxi. Target communities are over 90 per cent ethnic minorities, as these are demonstrably the poorest and most marginalised segment of the population, who, partly because of their geographic location in remote upland areas, have been largely beyond the reach of many government services.

The development model pioneered in Luquan and Weining was credit based: families received loans to raise livestock (predominantly pigs and chickens), including purchase of piglets or breeding chickens and the costs of vaccines and some supplementary fodder. The credit disbursement was coupled with intensive training in animal husbandry, both for beneficiary households and for village vaccination workers. It became the core of an integrated poverty alleviation strategy within the target communities, as provision of clean water and electricity were intrinsic to the success of the animal husbandry activity. It was not possible for beneficiaries to undertake the work needed to raise livestock unless time was freed up from long-distance water-hauling, and water could not be made available unless electricity was connected to pump it to the hilltop locations.

The credit component did enjoy considerable success by most standard indicators. Repayment rates in most communities were around 97 per cent, and this was among a population generally not considered credit-worthy, given their lack of collateral for loans and their previous lack of familiarity with any kind of formal accounting system.

Credit has since been used by Oxfam in a variety of other programme contexts. In Bama county of Guangxi, an area of chronic food shortage, the county government established corporatised poverty alleviation companies, intended to make branches of the agriculture services self-supporting. These companies would supply training and veterinary services at affordable fees to local communities, for raising pigs, rabbits and chickens which the companies would then market. This was kick-started with credit funds supplied by Oxfam to cover the credit capital and initial running costs. A similar model of intensive training for beneficiaries was followed, to minimise the considerable risk of the investment being lost when pigs became sick and/or died. In Lancang county of Yunnan, on the Burma border, credit-based schemes have been used to introduce both pig-raising and diversified agriculture (canola, vegetables) to increase family incomes. On initial indicators, several of these have been very successful in terms of repayment rates – once again, among populations not previously considered credit-worthy, and lacking collateral for loans – and in raising beneficiaries' income.

There have been some important differences from the Grameen Bank (GB) model, however:

- Credit has been disbursed and managed from a central point to individual households. Loan recipients relate directly to the community committee or to the officials disbursing, rather than being organised in small groups whose members both monitor and guarantee each other's loan performance.
- Later versions have moved to a more rotating model, where a community is at the outset divided into two to four large groups. The second group receives loans when the first group has repaid. This generates some community pressure for repayment, but not on the intimate and direct scale of the classic GB approach.
- Initial credit schemes were supported by a very high level of subsidy to the village and township officials providing management and technical services. The viability of the credit activity depended on considerable improvement in animal husbandry practice and pasture management. To achieve this, it was necessary to subsidise the budget of the government technical services.

These practices signal two important divergences in the approach to microcredit. First, the notion of building community solidarity did not really figure in the initial plans. The fostering of community formations outside the structures of the government and the Party was an alien concept in China until very recently, and the GB approach possibly would have been seen as a threat. Also, it has to be borne in mind that, in comparison to almost any other Asian society, the Chinese state, whatever its other failings, is exceptionally competent and pervasive. Credit schemes were seen as a useful pot of resources with which the system could function, rather than as a replacement system.

Second, self-sufficiency of credit activities has not always been seen as a primary or essential characteristic of the schemes. Interest payments have often not met the technical support costs, even when repayment rates have reached the optimal targets. The primary aim has been poverty reduction and, in a culture of state subsidies, there is no apparent contradiction in achieving this with a seemingly disproportionately heavy investment in support services.

More recent models of credit introduced by Oxfam have moved closer to the practices used elsewhere, in being built on more autonomous community management structures and in seeking a closer match between management costs and interest revenue. This has occurred in parallel to some relaxation of central state controls, including election of local village councils, and to the decreasing ability and inclination of the state to provide subsidies.

In a context where local governments are expected to pay much more of their own way, fee-for-service arrangements are much more readily accepted.

Viet Nam : Credit, poverty and sickness

Credit was key to an innovative primary health care programme supported by the Australian Freedom from Hunger Campaign, subsequently Oxfam–CAA, from 1992 to 1998 in Ba Ria-Vung Tau province in southern Viet Nam. The programme, supported by AusAID, sought to address the chronic health issues faced by the very poorest people living in all rural districts of the province. Many areas had been 'free fire zones' during the war and almost entirely depopulated. Large numbers of the inhabitants who had come since 1975 had been resettled from Saigon and Bien Hoa, or had voluntarily migrated from the overpopulated areas of the central north, to take up farming in forest clearings.

It was recognised early on by the local partners running the project that poverty was a key cause of ill health (quite a radical policy departure at that time), and that poverty alleviation strategies needed to go in tandem with resourcing of local health centres, training of community health workers, and provision of treatment for malaria and gastro-intestinal and respiratory diseases, which were the most common complaints of the poor. [2]

The first credit scheme intended to tackle this was set up in 1992 in Xuyen Moc, the poorest and most remote district, by the provincial project staff, all of whom were also cadres of the Party-run Union of Friendship Organisations. Ninety-eight particularly poor families, all of whom also had, or had suffered, significant health problems, were selected to receive loans directly by the project staff on the basis of data gathered by local health workers. The majority of loans were used to purchase piglets to be raised for sale, some were used to increase cultivation of cashews (the most important cash crop in the area) or other tree crops, and one or two to establish microenterprises such as basket-weaving.

The scheme was administered in a highly centralised manner by district or provincial cadres who visited the beneficiary families to follow up on loan instalments and related matters. There was no establishment of loan beneficiary groups, in the GB manner, or other attempts at the classic models of community development. This was in a province where political controls were particularly tight. Mobilising local community members into commune health groups to address issues of environmental health and sanitation had been seen as quite a radical departure.

In classic credit terms, the first round of loans was not a success. Repayment rates were around 70 per cent; several families defaulted outright and left the area. Several more failed in the income-generating activities chosen: most commonly, pigs died through lack of appropriate veterinary care. Even when training had been given, resources were unavailable in the most remote hamlets. In a large number of cases, the credit activity funded was successful in achieving return on the capital, but due to catastrophic circumstance, such as recurrence of severe malaria entailing high expense, or accidents resulting in long-term disability of a labour-aged family member, the income was not sufficient to stop the family going deeper into debt. A significant number of families did get through the loan cycle without meeting disaster, and managed to accumulate some savings and make long-term improvement in their living standards. All in all, it was not a textbook illustration of the effectiveness of microcredit. Some weaknesses in management could also be pointed to: follow-up with loan recipients had not been as systematic as was necessary, nor had the linking-in to veterinary and other support services been done as consistently as was possible, even allowing for the extreme limitations of these services.

It was illuminating, however, to have a colleague who was long-experienced in community-based microcredit across South Asia visit the programme and look at the outcomes with initial beneficiaries. She asserted that the scheme should in fact be judged a success, as, in selecting beneficiaries, the staff had consistently sought out the very poorest families. These frequently had at least one member with some chronic disability due to accident or physical or mental illness (with a noticeably high frequency in this area due to war trauma and the multiple stresses of chronic poverty). This usually meant that the family had only one or two able-bodied labour-aged persons, and a significant amount of their time might be taken up in caring for disabled members. This seriously limited the amount of time available for the credit-funded income-generating activities.[3]

Even the better-off among this cohort existed at an extraordinary level of vulnerability. There was little community cohesion in a disparate group of people resettled from elsewhere with high inward and outward mobility. Few had any extended family resources to call on. Even minor illness, accident or loss of money could have catastrophic consequences, and the scale of support or buffering provided by a normal microcredit loan was in most cases quite insufficient to prevent the debt spiral when this did occur.

This does point to what maybe a central fallacy in the promotion of microcredit as a means of poverty alleviation even for the very poorest. For the poorest, it needs to be accepted that some kind of external support will be necessary, and that not everyone can win on the free-market playing field. This view was borne out significantly in later rounds of credit elsewhere in Ba Ria-Vung Tau. Acute poverty existed in the other districts, and loan beneficiaries were often just as cash-poor as those in Xuyen Moc. This was noticeably mitigated by:

- longer-established communities: nearly all beneficiaries had extended family or close friends within reach who could provide some forms of assistance;
- better soils and water availability, making crops less vulnerable;
- less forest, and thus lower incidence of malaria;
- better access to technical services, including veterinary care; and
- better health services: even though government stipends were inadequate, health staff could make

sufficient income in private practice to allow cheap or free service to at least some of the poorest.

Under these circumstances, repayment rates for credit disbursed exceeded 90 per cent, and the instances in which families were able to further accumulate savings were far more numerous. Also, the later schemes had been introduced at a time when some political controls had been eased, and more locally managed models for credit could conceivably be established.

Viet Nam: Parallel state schemes

One significant influence on, and sometimes constraint to, managing credit for poverty alleviation in this province was the existence of similar government loan schemes. These loans, often of around the same size as those disbursed under the AusAID-supported scheme or slightly larger, most usually made to war veterans or their widows. Some were specifically targeted to ethnic minority groups whose loyalty to the state was being cultivated. They were also used for income-generation activity and were supposed to be repaid, at interest levels comparable to that of the AFFHC/Oxfam scheme, over a period of one or two years.

In fact, follow-up by the government agencies responsible was desultory. Several households interviewed had made few or no repayments and seemed unconcerned about whether or not they would be able to; apparently no pressure to extract the money owed was expected from the agency concerned. [4] This did create some problems when assumptions were made within a community that the Oxfam scheme would take a similar approach to credit management; in some cases, families had received loans under both schemes and did not readily distinguish between them. Taken as a poverty alleviation strategy per se, however, at least 60 per cent of the loans did seem to have been effective in creating an extra source of income for beneficiaries.

'Monetising the countryside': Government, NGOs and credit in Cambodia

Of all the socialist and formerly socialist countries of East Asia, Cambodia has unquestionably seen the greatest expansion of NGO activity, particularly since the repatriation from the border camps in 1992–93. A very large number of the 100-plus INGOs and the 200-plus local NGOs are operating microcredit schemes on some level, and there is an enormous variety in their structure and approach. For some local NGOs, managing extensive credit schemes is reported to have become a major source of operating funds. This is natural enough, given the lack of any in-country donor base and the uncertainties of overseas institutional funders, but it inevitably raises the question of where the balance sits between credit as poverty alleviation and credit as banking business, fair and ethical though the latter may be.

One illustrative moment came during the 1995 visit to Australia of a delegation from the then newly formed Committee for Development Cooperation (CDC) of the Cambodian government, headed by Minister Keat Chhon. At a meeting of Australian NGOs held at the Australian Council for Overseas Aid in Canberra, he expounded his vision for rural development in Cambodia, and the roles that various actors (government, UN, community, foreign donors) would play in it. When asked what he saw as the particular contribution of foreign NGOs, he gave a clearly articulated vision of NGOs at the front line, in the more remote and difficult parts of the countryside, where government services currently had the least reach and where social organisation was least cohesive. In this, he said, a high priority was 'banking' (giving the equivalent term in French, and clearly groping for the NGO language), clarified in translation as 'credit'. Warming to the issue, he said he wanted NGOs to take the lead in 'monetising the countryside'.

Clearly, linking subsistence farmers and fishers into market systems can be a strategy for poverty alleviation; doing so in a manner which does not aggravate the exploitation and disempowerment they suffer is one of the key tasks for NGOs focusing on livelihoods. But the terms in which this was expressed by the minister did show the difference in the ways in which microcredit can be viewed. From the macro-policy level at that time, empowerment of the most marginalised, or equalising the situation of the very poorest, would be seen at best as an incidental by-product of universally available credit, and developments in large-scale credit practice since then would seem to bear this out. If the very poor do have access to affordable credit anywhere, it is via some NGO schemes, but by no means all of them. In one instance in Bantay Meanchay province in 1997, a local NGO partner of Oxfam was resistant to widespread use of credit as part of the resettlement of internally displaced people. It should not be extended to the very poor, they said, because they would not be able to repay.[5]

Women's organisations and credit

In all four countries those credit schemes that have been effectively run have usually been run by women's organisations: in China, Viet Nam and Laos, the Party-linked 'mass organisations' (All China Women's Federation, National Women's Union, Lao Women's Union, respectively): in Cambodia, the NGO successors to the Revolutionary Women's Association have also been prominent in this field.

Their great advantage has been that they extend into every village in the country, often with an active membership base, and their cadres are frequently among the most competent and dynamic officials in the province or district. In comparison to the other mass organisations (youth, peasants, ethnic minorities, in particular), they tend to have the most effective function and credibility among their membership. They have also made the most successful transition into post-reform scenarios where the role of the Party and allied bodies is no longer totally dominant.

Effective credit management has been possible through the women's unions because the whole structure is already in place down to hamlet level, with clear lines of reporting and accountability, offering obvious channels for training, and access to government at policy level. They have also had a clear brief for pursuing women's rights and interests, albeit within the fairly rigid parameters of Party policy, and usually not with a very clear analysis of women's strategic needs. More often, the stated aim is to raise women's capacities in order to allow them to achieve equality. Within this framework, however, there has at times been quite committed pursuit of women's interests, particularly at provincial level and below.

In becoming managers of large numbers of credit schemes, these organisations are now facing the same challenge to their role as are women's NGOs elsewhere in Asia. State funding has substantially diminished, or atrophied altogether, since the mid-1980s. This has been true to some extent for all state and Party instrumentalities, but probably most so for the women's unions and other low-status bodies. The All China Women's Federation, for instance, continues to receive funding for its cadres' salaries and to maintain basic infrastructure, but on-going discussions with staff indicate the Federation has negligible state funds available to implement their official mission. In many cases, the organisations have addressed this by becoming the implementing partners of foreign aid donors (government, multilateral and NGO), allowing them to take the associated management fees for projects contracted, and thus maintain their staffing and infrastructure. Being dependent on this, however, in some cases seems to mean the entire organisation is at risk of becoming preoccupied with immediate project management issues, and losing such a role as it had in struggling for greater gender equality.

Conclusion

In the last decade, microcredit has seen an extraordinary expansion in China and the countries of the former Indochina bloc, with credit schemes now operating with government or NGO support in even the most remote areas. As the economic structure in these countries has come to more closely resemble that in the rest of Asia, so too have similar issues arisen in the direction and purpose of microcredit, which has become a regular component of a wide range of development strategies.

For all their inadequacies and inefficiencies, previous state-run structures did have a clear mandate for poverty alleviation. When the remnants of state welfare systems have combined with the microcredit approach, it has sometimes led to bad credit practice, but effective relief of poverty, at least for individual beneficiaries. In other instances, the inequities and related social attitudes which elsewhere in the world prevent the poorest from benefiting from credit-based schemes have been alarmingly quick to emerge in the post-socialist context. In China and the former Indochina, as much as elsewhere in Asia, management of microcredit clearly does not automatically deliver improvements in women's strategic position in their families and communities, and carries with it the same risks of increased burden of labour and responsibility. Another group of risks is associated with communities previously unfamiliar with market mechanisms contending with unpredictably fluctuating prices for the commodities they produce with credit.

Some credit schemes which consciously target the very poor, and even the poorest, and specifically build in measures to address women's strategic needs have delivered significant improvements in both income and quality of life for their beneficiaries in these countries. So far, however, it appears that the lessons learned have not been recognised or assimilated into the large-scale microcredit schemes which are increasingly prevalent.

Notes

1. In 1988 there were 12 NGOs with offices in Phnom Penh. In early 1993 there were over 120 (personal direct observation and records of the NGO Committee for Cooperation on Cambodia).
2. Preliminary report of the Xuyen Moc District Primary Health Care Program, Australian Freedom From Hunger Campaign internal document 1991.
3. Evaluation report on Ba Ria-Vung Tau Primary Health Care Program, internal document to CAA, September 1997.
4. Evaluation Report *op.cit.*
5. Conversation between CAA and local NGO officer in Bantay Meanchay province, December 1995, reported to author.

The Internal Learning System: A tool for microfinance and livelihoods interventions

Helzi Noponen, Independent Consultant

The Internal Learning System (ILS) is a participatory impact assessment and planning system for non-government organisation (NGO) development programmes. It is 'internally driven', designed primarily to meet the learning needs of participants and programme staff. Participants use the system to track and analyse changes in their lives; they use the understanding to alter their strategies as they participate in the economy and interact with actors and institutions in the wider community. Programme staff use the system to meet a variety of impact assessment objectives, including 'external proving', that the programme is having its intended impact.

The aim of the ILS Project was to create a participatory monitoring and impact evaluation system that would respond to the on-going internal needs of organisations to learn what is working and not working, so that changes could be made in a timely manner. This emphasis on the impact assessment objectives of internal learning and improving programme operations is the strength of ILS. The system was also designed to strengthen stakeholder relationships and to build participant understanding and analysis skills.

Key features

ILS is a simple, on-going system used by all participants. The medium is multi-year pictorial diaries suited to the illiteracy and poverty conditions of participants and to longitudinal perspectives of the process of development change. Using pictures that represent an impact indicator, poor illiterate women can keep a record of change over time by simply ticking quantities, yes/no responses, and performance and satisfaction ratings. The diaries can be used on a total programme population (or on a sample), yielding a quantitative and qualitative panel dataset that contains information on changes in participant lives at a baseline period, with periodic summary assessment intervals over a multi-year period.

The veracity of the data is vetted at other programme levels, where individual data are aggregated in a participatory sharing process into group, cluster or field organising staff, and programme diaries. This results in a streamlined and decentralised system that reduces the drudgery of data collection, while enhancing mutual learning and strengthening stakeholder relationships.

Data are not collected and analysed solely by managers at the top. All participants are involved in each aspect of the ILS process. Each level carries out five tasks: collecting data; assessing change; analysing causes of change or troubleshooting; planning and training; and documenting, sharing and reinforcing programme values. Participants at each level reflect upon their findings, summon user-driven training inputs, make plans, and document their experiences in their diaries. There is a direct and immediate link between the real-life changes of participants and planning and training responses.

ILS is flexible. The structure, content and processes can be shaped to the needs, human resource capacities, and financial constraints of different organisations. Structure can be varied according to the programme levels using ILS diaries, and whether or not data are collected and/or analysed on a sample or a census basis. Content is determined through the inputs of all users, including poor members, in a participatory stakeholder analysis. ILS users can also opt to select, forgo or enhance upon a set of ILS processes. Some observers fail to see beyond what is most visible – pictorial participant diaries that contain 'distilled' development indicators – to the interactive and participatory investigation process that yielded the indicators in the first place, and which analyses and responds to the data results in the second place. (See Simonowitz 2001 for impact assessment objectives and ILS.)

ILS structure

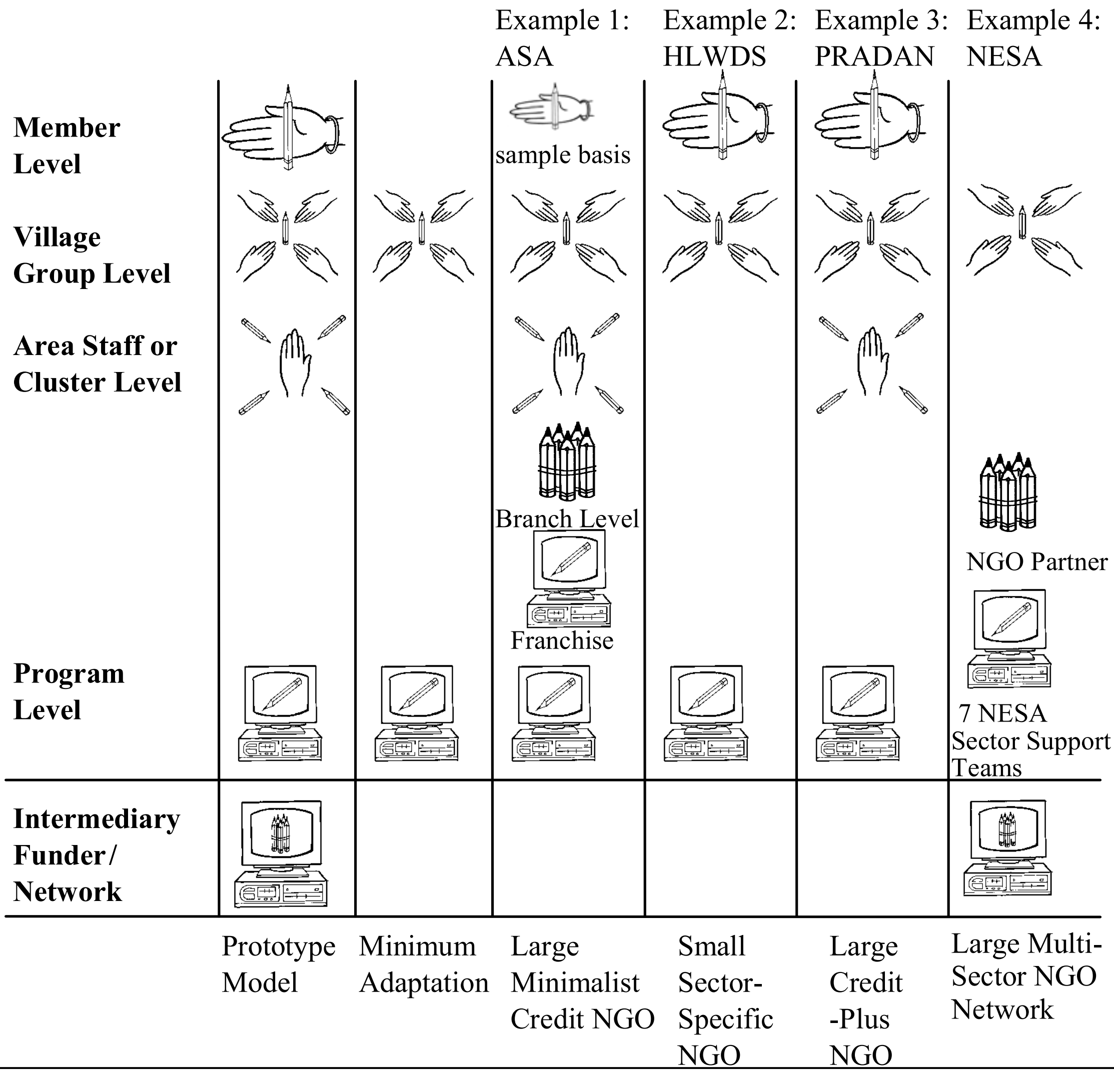
ILS can be adapted to the structure of a typical or self-help group (SHG) microlending programme that has a multitiered system of establishing and strengthening village-based loan groups of poor borrowers, typically women. It can also be used for member and group-based livelihood and other development programmes. The levels are each represented by a symbol or icon, and there is considerable flexibility in deciding the starting-point for ILS and in skipping levels, depending on programme structure and needs.

Figure 1 shows the structure for the ILS prototype, with all levels conceived in the original design, as well as a minimum option, and adaptations by four NGO development programmes in India: Activists for Social Alternatives (ASA), Handloom Weavers Development Society (HLWDS), Professional Assistance for Development Action (PRADAN) and New Entity for Social Action (NESA).

Adapting ILS to meet programme and participant needs

The first step in adapting ILS is to make careful decisions on structure, content and processes so the resulting system is well suited to the needs and constraints of participants. There is no off-

Figure 1: ILS Structure and four examples of ILS NGO adaptations



the-shelf standard model. The ILS Resource Kit, currently being developed, contains training manuals, adaptation examples, and rationales and materials that help guide programme managers through the initial design process.

One manual specifically guides adapters through the process of carrying out a stakeholder analysis to identify programme stakeholders and their stakes in the success of the development intervention. This is the first step in determining impact questions and specific analyses for each participant level, which ultimately determines the selection of development indicators in the diaries. A set of PRA exercises, such as specially designed picture-led focus group discussions, is suggested to elicit the learning needs of poor women and village groups. A pictorial impact diary is then prepared for participants at each level.

A crucial caution at this stage is to separate out impact questions that are best answered using methods other than ILS, such as those that require complex calculations or a high degree of facilitation to uncover individual or family-specific idiosyncrasies. These are better suited to sample coverage using survey interview techniques to reduce data error in information collection and processing. ILS adapters should also make sure that members and village groups are not burdened with collecting information that is solely of use to programme managers. Every indicator included in the member or group diaries has a primary 'learning' use for the member or group.

This is usually not a big problem, as the overlap between the interests of programme managers and what members and groups want to track is quite large and with some creativity can be made interesting to participants. Managers, for example, may wish to track changes in dependency ratios. Using a picture of a scale, participants can be taught to draw stick figures for each family member in one balance arm and the number of earners in the other. The exercise can be repeated yearly. Analysis, training and planning activities can focus on balancing household size and the number of income earners and link this indicator to others, such as loan use, enterprise planning issues, and reproductive health issues.

How ILS works

The SHG member is the first provider and user of impact information. Her learning is paramount. She has in her hands a diary that reflects all the important issues in her life. She notes changes in these indicators as and when they occur, and she gives summary tallies at periodic assessment periods. She also carries out exercises in problem identification, goal setting, choosing priorities, and planning.

The SHG is the second provider and user of impact information. Group members share their learnings with one another. The group leader, using participatory methods, aggregates all of this information into a group total and records it in their pictorial group diary. Groups also track their progress in becoming a viable group along ten dimensions of group functioning (10 ten-point rating scales for a composite score of 100). Programme stakeholders select the dimensions and the ten rating criteria. Dimensions chosen by current adapters include: knowledge of SHGs, attitudes of SHG, attendance and punctuality, holding meetings, participation, maintaining accounts, keeping records, group cohesion, problem solving, leadership, networking and federation activity, bank linkage, resource mobilisation, institutional linkage and information access. Groups also track their collective efforts in improving infrastructure and services in their community to capture some of the wider impacts of SHG-focused interventions. They assess which impact areas are problems and they summon user-driven, pictorial poster-led training inputs and undertake group planning exercises to solve them (see Noponen 1999 for further detail).

The field organiser is the third user of information. She enters impact data on each of her groups and also provides new information on the relationship between intervention inputs (her efforts to assist groups in her area) and the impact performance of groups. She also carries out 'force-field' analyses on lagging and excelling groups to uncover reasons for performance results. The organiser analyses the impact data and revises training and input plans for each group accordingly. If organisers are computer literate, they can enter the information into a pre-formatted spreadsheet which they pass on to programme managers. This reduces the drudgery of data entry on groups, as it is spread among a large number of staff.

Programme managers learn about impact results from field staff through their diaries and spreadsheet entries. At the programme level, staff can undertake analyses on a sample basis of member-level data to understand individual reasons for success. They can analyse the group-level data on a census basis to understand the influence of group characteristics, programme inputs, organising strategy, or area factors in impact performance. A menu-driven software is being designed to make data entry easier and to automatically analyse and graph results, including the highlighting of lagging and excelling groups. Qualitative assessments are synthesised in yearly ILS retreats for staff. The process yields a 'Do's and Don'ts' List which, when illustrated with case examples and cautionary tales, becomes the basis of a Programme Best Practices Guide.

The funders learn about impact results in yearly ILS Reports and Best Practices Reports. The NGO monitoring or research officer prepares these reports. They include not only the disaggregated quantitative programme-wide results, but also a synthesis of the qualitative assessments and learnings from the ILS retreat exercises.

The impact data and assessments can be used by outside researchers if their interests are compatible with the organisation. ILS can yield a rich dataset covering a variety of indicators. Researchers can take a random sample of participants and use the panel data in their diaries, in combination with additional and more in-depth probing on certain issues, to answer more complex impact questions regarding microcredit and livelihood interventions. If certain researchers are interested in the ILS diary feature that overcomes the problems of recall, they can formulate special diary pages on their research indicators for a sample of ILS users. They can motivate them to keep track of the special information and perhaps compensate them appropriately (providing a group asset) for their contribution.

Frequently asked questions

How does ILS address the question of attribution of impact results to programme intervention?

The quantitative data can be analysed on a panel basis: are the same women strengthening their livelihood base and improving their levels of welfare and empowerment over time? It can also be analysed on a cross-sectional basis by membership age or number of loans: are older members who have been experiencing the intervention for longer periods of time doing better than newer ones? The data analysts would use newly joined members, having the same selection characteristics as older members, as a proxy control group of non-members. It is important to carefully determine that selection criteria as well as selection outcomes for SHG membership have not changed over time. Often pressures for financial programme sustainability may result in a rise in the initial wealth status of new members.

Demonstration effects of a large number of existing SHGs in a project area and previous policy lobbying efforts by the NGO can dramatically affect the local environment and contaminate this analysis. For example, PRADAN has noted dramatic changes in several of their field sites: where previously it had taken SHGs four years to link with formal banks, newly established groups are linking within 18 months. The organising staff credit the change to their efforts to train and sensitise bank staff and to the fact that the idea of women joining self-help savings and credit groups is now widely accepted in the community after observing the success of earlier groups.

The ILS process focuses on understanding what is working and what is not working, for whom, and why. Members can compare their own impact results with the average for the group. Together in a group process, members can explore factors that might be important in explaining why some women do better than others through a ‘physical cross-tabulation and discussion’. Likely comparison indicators for a cross-tabulation will include programme-related factors such as number or amount of loans taken, years in the programme, productive use of loans, high savings, and also personal or family-related factors such as skill levels, low debt levels, health problems, and small family size. In an unprompted and open-ended exercise, subgroups can also discuss the possible reasons behind their experiences and then share these insights with the entire group. The group as a whole can comment on the issues that arise from the members’ own experiences.

The field officer identifies under-served, over-served, ‘problematic’ (low impact despite high inputs) and ‘exceptional’ (high impact despite low inputs) groups. She adjusts her area plans for the first two result squares by increasing or decreasing (redeploying) inputs. For ‘problematic’ and ‘exceptional’ groups, she carries out pre-structured and open-ended force-field analyses. The force-field analyses probe for a set of possible reasons – environmental, demographic or programme-related – that might be correlated with lagging or excelling impact performance.

How does ILS compare with PRA/PLA techniques?

Although ILS and PRA/PLA activities have contrasting features, the two methods can be combined in a manner that overcomes the strengths and weaknesses of each. ILS already uses several participatory exercises to elicit participant needs and views in the ILS diary content including specialised focus group discussions, well-being visioning, livelihood analysis and social mapping. PRADAN in its ILS adaptation has opted to record these initial PLA pictorial diagrams and images and store them at the appropriate ILS diary level. Some of these exercises may be one-off, some may be repeated at interim or end points. Participants in the ILS ‘train and plan’ modules will make use of this PLA information just as they do their entries on the ILS indicator picture cells in order to ground the ILS training and planning exercises in the real-life experiences of members. This overcomes the disadvantages of some PRA/PLA techniques in which the exercises are one-off events and there is little continuity or follow-up over time. It overcomes the disadvantage that the outcome of the exercises is not preserved so that they can easily be revisited and reflected upon as change occurs.

Participatory exercises may be revisited or newly undertaken to follow up on unusual or interesting results in the diaries. If, for example, the results of two indicators are contradictory or go in unexpected directions to each other and normal ILS analysis and troubleshooting exercises do not uncover the reasons, a more in-depth PLA exercise may be needed. The PLA exercises may be particularly useful in helping to reveal the economic or gender-related constraints in livelihood improvement. This flexible and modular approach to the use of a few key PLA exercises, along with the ILS diary, will strengthen user-driven training and planning activities. Groups will draw on these more in-depth learning activities as and when they need them, adding them to their existing learning diary.

ILS techniques have also been used by PRADAN to reduce the time and level of facilitation required in carrying out standard PRA/PLA techniques such as social mapping. A pre-formatted pictorial household profile (half-page size, with a tear-away identical copy for programme managers) that each village household could complete themselves using ticks replaced the use of beans, stones and other cut-out paper symbols. This drastically reduced the time it took to construct the village map on the ground, while at the same time increasing participation of each villager. Within only 45 minutes, illiterate villagers had completed their profile page and discovered that they could ‘read’ each other’s story on the profile page. It was an easy matter to lay the pages on the ground according to the village housing pattern and add community-wide symbols to the map. The profile pages are numbered so villagers can quickly re-assemble the map in the future for visiting officials. Similar ILS-style versions of PRA exercises have been developed for livelihood and expenditure trees, reducing time and facilitation skills, while preserving outcomes.

Isn’t ILS a burden on women participants?

Very poor and illiterate women are able to keep an impact diary, recording changes in their lives. They have also participated in the analysis of the collected information and made revisions in their individual and group plans. For HLWDS participants, the use of ILS diaries has had a strong catalytic effect in increasing women’s confidence and motivation to improve their situation, especially regarding the problems of domestic violence and male alcoholism (Noponen 2001). These women have also successfully used their diaries to verify their low-income status with development officials and to lobby for eligibility in housing and work asset grant programmes.

Beyond these material and social status gains, women workers in this neglected sector repeatedly express appreciation for the fact that the diary reflects all of the aspects of their work and home life back to them. They are galvanised by the fact that they can ‘read’ the pages on their own. This is a powerful effect for poor, illiterate women who are marginalised in the world of the written word. Women users have been very active in determining the content of the second edition of the diaries.

What are some cautions in using ILS?

The complexity of ILS lies in making the initial choices regarding structure, content and processes wisely, not in the system itself. There is no shortcut to a proper research design beginning with the desired analysis and ending with proper questionnaire construction and field-testing, especially for a questionnaire in pictorial format. The danger is that NGO adapters can become overly focused on ILS content or the attractive pictorial aspect of an ILS diary, either copying one designed for another NGO programme or selecting pictures from the ILS Indicator Bank without thought to the entire research process. Without careful analysis of ILS design issues and programme needs and constraints, an NGO may also try to do too much and to exceed capacities. The ILS Resource Kit has been designed to guide potential adapters through this process in a rational manner.

An important caution is that ILS should only be undertaken where there is a culture of organisational learning in which staff and managers welcome learning from poor as well as good results. NGOs should also carefully consider their objectives in impact assessment. If they are primarily interested in external 'proving', they should select another method that emphasises statistical rigour rather than participatory learning. ILS is best suited to NGOs that place more emphasis on the 'improving' aspects: 'internal learning', 'strengthening stakeholder relationships', and 'building participant understanding and analysis skills'.

Conclusion

ILS fits well into new trends in the impact assessment of development programmes, especially in the microfinance and livelihoods sector. It can meet a variety of objectives while balancing the learning needs of participants and programme staff. Its strengths lie in yielding quantitative and qualitative information for 'improving' programme operations and enhancing participant involvement. It can also contribute useful information for 'proving' impact to internal and external stakeholders.

ILS is an internal, on-going system that can become a seamless part of normal NGO operations. Its strengths are that it is simple, participatory, decentralised and streamlined, tracks changes over time, uses a wide range of indicators, with impact assessment linked to user-driven training and planning responses, and is flexible and responsive to local needs.

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Microfinance as a vehicle for educating the poor

Christopher Dunford, Freedom from Hunger

Introduction

Microfinance can be a powerful tool for giving the poor more economic options. However, the very poor need more than microfinance to address the causes and conditions of their poverty. Ideally, they would have access to a coordinated combination of microfinance and other development services to improve business, income and assets, health, nutrition, family planning, education of children, social support networks, and so on. The question is how to ensure a 'coordinated combination' of appropriate services, especially in rural communities and other communities where multiple services are simply unavailable.

Microfinance practitioners are often motivated to provide non-financial services to their clients, because they recognise the need and hear the demand. However, the legitimate concern for sustainability, interpreted as the financial viability of the microfinance service as a business, has made practitioners very cautious about non-financial add-ons. They believe that add-ons can only be a drag on the drive for sustainability. Where other, non-financial service organisations can provide these other services for the same clients, some microfinance practitioners have fostered referrals and common points of service with their non-financial counterparts. But most microfinance institutions (MFIs) feel compelled or prefer to focus solely on the financial needs of their clients and do not attempt to meet their non-financial ones.

On the other hand, group-based microfinance provides a good opportunity to provide low-cost education services needed by the poor, if only to improve their performance as microfinance clients. This is especially true for village banking and related delivery systems (for example, Grameen Bank) that bring large groups of relatively poor clients together in regular meetings. Good, non-formal adult education techniques can be used effectively at these meetings to cover a variety of topics. Examples include promoting changes in child care, personal health habits, and use of local health services, as well as improvement of business skills that enable microfinance clients to put their loans to more productive use and generate more profit and savings.

Integration scenarios

In this article, service 'integration' refers to the coordinated delivery of different-sector services to the same people. There are three common scenarios for integrating microfinance with other services: linked, parallel and unified delivery.

Linked delivery

This scenario involves *different* organisations and service delivery staff, but the *same* end users. When there are several development service providers in a target area, as in many urban and peri-urban areas, an organisation may reasonably choose to specialise as a microfinance business. Ideally, different organisations offering different services would coordinate their marketing, including delivery at common points of service and mutual referrals, as clients' needs for other services arise. Many specialist MFIs could embrace this scenario, but few reach for the 'ideal' of coordinated marketing with non-financial service providers.

One longstanding example is the close coordination of the Bangladesh Rural Advancement Committee's (BRAC's) Rural Development Program (RDP), with the Government of Bangladesh and World Food Program, food distribution to the 'hard-core' poor. The relationship is mediated by the Income Generation for Vulnerable Groups Development (IGVGD) programme, jointly administered by BRAC and the Government of Bangladesh (CGAP 2001). The IGVGD links government food distribution to the very poor with a special BRAC effort to prepare destitute people for normal participation in the RDP. Otherwise, these people would not have even the minimal skills, resources or opportunities required for participation.

Parallel delivery

This scenario involves the *same* organisation and end users, but *different* service delivery staff. A generalist or multipurpose organisation may offer not only microfinance services, through specialist microfinance programme staff, but also other sector services through different programme staff of the same organisation – to the same people in need.

BRAC again provides a good example. The RDP, the 'normal' version to which IGVGD beneficiaries can graduate, serves 3.64 million members (97 per cent of whom are mostly illiterate women) with both financial and non-financial services to their Village Organisations (VOs). The VOs are composed of seven to eight solidarity groups of five members each. The financial services include four types of solidarity group loans:

- general – for whatever the borrower chooses and her solidarity group approves;
- programme – to support particular activities promoted by other BRAC programmes, such as poultry, silk culture and social forestry;
- housing – to help VO members to build homes; and

- rural enterprise – to set up in rural areas non-farm businesses, such as small restaurants, grocery stores, or laundry and tailoring shops.

The VO meets weekly with the Program Organiser (PO) responsible for credit to collect savings (minimum of US$0.90 a week, earning 6 per cent a year, withdrawn only upon departure from VO membership), to decide who should get loans, and to make loan repayments.

Non-financial services are provided by different POs, who also travel by bicycle to meet with the VOs and to see individual members. The social development POs provide general education at the monthly *Gram Sobha* (village meeting). This provides a forum where women can learn and gain information informally through discussion and consultation with other members and BRAC workers. Various socioeconomic, legal, health and political issues are discussed, including the need to prevent early marriages, how to stop domestic violence, how to prevent illegal divorces or bigamy, and where to access various types of services, such as immunisations. The social development PO is also responsible for offering new VO members a 30-day course on human rights and legal education.

A third PO for health provides the Essential Health Care component of the RDP. This PO facilitates a monthly education forum in the community, for both VO and other community members, covering various health issues such as local food sources of vitamin A, good nutrition during pregnancy and lactation, protection against six killer diseases through immunisation, use of slab-ring latrines, and use of delivery kits for safe childbirth. Each meeting covers a new topic, has roughly 20–25 participants, and lasts around 45–60 minutes. The health PO encourages learner discussion and participation with the help of community health volunteers. Through the health POs, the RDP is also providing prenatal and postnatal care at the community level and has established referral linkages with the basic and comprehensive Emergency Obstetric Care unit of the government.

The total cost of delivering financial services includes all financial costs of capital lent to clients as well as all costs of external technical assistance. Based on financial performance in 2000, BRAC's RDP credit programme was projected to completely financially self-sustainable in 2001 and beyond. During 2000, the credit programme actively expanded from 3.2 million to 3.64 million members, which lowered that year's financial self-sufficiency ratio below 100 per cent.

From the surpluses generated through the credit programme and some of BRAC's sector programmes, such as poultry, silk culture, social forestry, outside the RDP, BRAC is able to fund some of its educational programmes. Still, all of the educational and training components are expected to rely partially on external funding for the foreseeable future.

Unified delivery

This scenario involves the *same* organisation, service delivery staff, and end users. When the people in need have access to few, if any, other development services, as in many rural communities, and the MFI cannot afford a long-term commitment to provide two or more services with different specialist staff, it may choose to field only one set of staff tasked to provide microfinance with another service. The organisation may even seek to hold its costs to a level that it can sustain solely with revenue generated by the unified service itself.

Credit with Education providers are good examples.[1] Credit with Education comprises elements of the Grameen Bank, FINCA village banking, USAID-sponsored child survival programming and principles of non-formal adult education. A more complete description of the model is provided by Vor der Bruegge et al. (1995).

FUCEC-Togo offers a specific example of Credit with Education in the institutional context of credit unions. This credit union federation and its member credit unions offer Credit with Education (Service Crédit-Epargne avec Education, or CE/E) as one of several financial service products. Credit with Education gives the FUCEC-Togo credit unions the opportunity for outreach to serve people who otherwise could not join a credit union, specifically poorer women in more remote rural communities.

FUCEC-Togo invests part of its central liquidity fund, in which all member credit unions invest part of their individual members' savings on deposit, as loans to groups of women who cannot or will not join as individuals, because of the high cost of membership: shares are too expensive, they cannot save sufficient amounts to get needed loans, the nearest credit union is too far away, credit unions are perceived to be for men. These groups are called Groupements d'Interêt Economique et Social (GIES) and are composed of 18–30 (average 24) women, subdivided into solidarity groups of four to seven. These groups deposit savings in the credit unions in group accounts, but they are 'net borrowers'. They join the credit union as a group and do not have the same rights as regular members to 'one person, one vote' participation in the governance of their credit union, nor access to any financial services other than those delivered to the GIES.

A GIES meets in its own community with a FUCEC *promotrice* (field agent) for one to two hours each meeting – weekly for the first few 'loan cycles' (16 weeks each), then bi-weekly as the group demonstrates its reliability. One *promotrice* meets with the group for the joint purposes of providing savings, credit and educational services at the same meeting. The GIES are generally located in rural areas served by public transportation once in a week. Therefore, the *promotrices* travel to their meetings on motorcycles provided by the Service CE/E.

The Service CE/E made its first loans in April 1996. The value of those outstanding at 31 December 2000 was US$1,470,000 to 13,540 active borrowers. The average loan size was US$109 in 550 GIES served by 21 *promotrices*. The credit union makes a loan to the GIES as a group. The GIES then on-lends to its members for any activity approved by fellow members. The members are not required to borrow, but 98 per cent had loans at the end of 2000 (www.microcreditsummit.org/papers/healthintro.htm).

To receive education from the Service CE/E, women must be GIES members, attend the weekly or bi-weekly meetings and be current savers. Topics covered deal with health and nutrition, diarrhoea prevention and management, breastfeeding, infant and child feeding, immunisation and family planning, better business development including increasing sales and knowing your real profit, and GIES management.

Almost every GIES meeting, except when loans are disbursed by the *promotrice* or repaid in full by the group, includes a learning session. Each session takes about half an hour. Each topic, like family planning, requires several sessions spread over several meetings, generally concentrated in one 'loan cycle' of 16 weeks duration. Learning sessions are led by the *promotrice*, with assistance from the women in the groups. She uses short 'dramas' and sometimes visual images to introduce the subject, and various discussion facilitation methods to encourage everyone's contribution to develop and convey the key messages.

As of the end of December 2000, income from credit operations covered 97 per cent of the unified costs of the Service CE/E. Grant funding for start-ups in new areas has been provided by both PLAN International and Freedom from Hunger. Technical assistance funded externally is not included as revenue or expense in the tracking of programme costs. However, all these costs were included in a cost accounting analysis of the first three years of the programme (Vor der Bruegge et al. 1999). The average percentage of total costs that could be attributed to the 'extra education' (that which would not be provided by a standard village banking programme) was 8 per cent. While there is no comparable cost analysis for the year 2000, note that the costs of 'extra education' are included in the calculation of the 97 per cent operational self-sufficiency for the end of 2000.

Its experience with the Service CE/E has convinced FUCEC that education added to small loans and savings is essential for changing the lives of poor people in rural communities. Despite difficult economic conditions that limit the potential of their microenterprises, poor women have stayed with the programme, according to FUCEC, because they enjoy fellowship with others and the information they receive during learning sessions. This has helped the financial self-sufficiency of the programme as well as helping the women. In addition, FUCEC has become convinced that the financial and educational services can be efficiently and effectively delivered together by the same *promotrices*.

Parallel/linked v. unified service delivery

In the cases described, each organisation is committed to full financial self-sufficiency of the microfinance operations, but satisfying the broader needs of the clients is as important, it seems, as financial self-sufficiency of the overall institution. Where they differ is in their deployment of managers and field staff. Only the Credit with Education providers (exemplified by FUCEC-Togo) are using the same managers and field agents to deliver both microfinance and non-financial services, and only they are coming close to full recovery from the clients of all costs for the full range of services. But BRAC, being willing and able to rely, in large part, on external funding, offers a broader range of services to its clients.

In general terms, the major challenge to the parallel scenario is the sustainable financing of the non-financial service, whereas the major challenge to the unified scenario is the management of field staff tasked to deliver different-sector services. It might appear that the linked scenario escapes both of these problems, and in theory it does. In practice, it is very hard to maintain over time and over large service areas. Totally independent organisations have different missions, strategic plans, managers, and revenue sources. Those differences are likely to limit overlap in target populations and service areas and also to pull the organisations apart over time, ending the linkage agreement. The linked scenario in practice is the one least likely to reach major scale and be sustainable, but it works for BRAC and the Government of Bangladesh.

An MFI considering delivery of additional services in non-financial service sectors should ask itself the following questions:

- What additional services are required by the institution's own development objectives?
- What additional services are required to satisfy the needs and wants of the intended clientele?
- What are the feasible options for providing additional services that meet both institutional objectives and client objectives? Links to other, non-financial service providers? Creation of a separate institution to provide non-financial services? Creation of a separate non-financial service unit within the institution itself? Unification of the non-financial services with the existing financial service delivery system?
- What targeting measures will be needed to ensure that the client group reached does not exclude the poorest households?

The unified delivery option is the most demanding, but it also may be the only option or the one most likely to be sustainable in the long term. Even then, unified delivery is advisable only when the institution wants to add one or more forms of education to microfinance services for relatively large borrower groups that meet regularly with field agents of the institution.

The education should adhere to the principles of effective adult learning, but the content can be varied or singular and drawn from structured curricula or facilitated exchanges of knowledge among the clients themselves. A mix of approaches (as in Credit with Education) can be used. But the education programme, whatever it is, must be manageable by the same people (clients and staff) who are involved in the management of the financial services.

Smith and Jain (1999) have put forward the reasonable idea that the quality of either microcredit or education must be compromised for the sake of unified delivery. In other words, the efficiency and effectiveness of services are diminished (and impact is compromised) when delivered by multi-tasked generalists rather than by focused specialists.

In contrast, Freedom from Hunger has done considerable research (especially the studies in Ghana and Bolivia: MkNelly and Dunford 1998, 1999) to verify that Credit with Education is having the intended impacts in three areas: improved economic capacity of women, empowerment of women, and adoption of key child survival health and nutrition practices that lead to measurable change in food security and nutritional status. Other impact studies (including those by or for BRAC and FUCEC-Togo) yield similar findings. Impact studies for microfinance-only programmes have shown financial results similar to those found in studies for Credit with Education programmes. The addition of health and nutrition education does not appear to keep village banking from producing the significant economic and empowerment impacts sought in microfinance programming. Likewise, impact studies for stand-alone health and nutrition education programmes show results similar to those found in the impact studies for Credit with Education programmes. Therefore, it seems the education in Credit with Education can be as effective in stimulating health and nutrition behaviour change.

Is the unified, self-financing scenario possible? Is it feasible? Is it effective? The answer appears to be 'yes' to all three questions when applied to certain types of microfinance and certain types of education delivered together. Integration is only for those whose objectives call for providing multisectoral services to address multiple needs/wants of the very poor. Unified integration is only for those with the need and the will to lead and manage staff towards long-term independence from operating grants. As an organisation considers the unified option, it should understand why this option is more demanding and be realistic in assessing its commitment.

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Notes

1. Each Credit with Education practitioner develops its own operational system for self-financing, unified delivery of microfinance and education to poor women. Credit with Education was first developed by Freedom from Hunger in 1989–90 for the purpose of improving household food security and child nutrition. As of 30 June 2001, Freedom from Hunger had assisted NGOs and community-based financial institutions in 15 countries to start their own Credit with Education programmes. In aggregate, these implementing organisations were reaching 189,540 women, of whom 153,733 were taking current loans averaging US$73 each. The total amount of outstanding loans was US$11.2 million, and the total amount of savings was US$2.6 million. The weighted average for operating self-sufficiency, of the implementing organisations reporting complete revenue and expenditure data for the previous six months, was 92 per cent. Overall portfolio at risk was 3.86 per cent. Other versions of Credit with Education have been developed by other organisations in the past decade without Freedom from Hunger assistance, notably by World Relief Corporation and Project HOPE (www.ffhtechnical.org).

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Viewpoint

Moris Rasik: Reflections from the field in Timor

Helen Todd, CASHPOR[1]

Introduction

Moris Rasik is a microfinance programme, targeted exclusively at poor rural women, operating in the border districts of Bobonaro and Covalima in Timor Loro Sa'e. The programme follows a solidarity group model, adapted from the Grameen Bank in Bangladesh. First loans were disbursed in November, 2000. The programme is managed by CASHPOR, a network of Asian MFIs, but aims to build a self-sufficient, Timorese institution operating across the western districts within five years. It is funded by a number of private foundations and government donors, including Grameen Foundation USA, AusAID and TOUCH Community Services in Singapore. Helen Todd is its Managing Director.

Flashbacks over 15 months

Moris Rasik is now 15 months old. I must admit to some surprise that we have actually survived; that we have 600 clients still with us and a portfolio at risk that has dropped back to 1 per cent.

I see this time as a series of flashbacks:

> *Ahasan Ullah Bhiuyan, pioneer Programme Manager, struggling across a flooded river, muddy water up to his thighs. I am following, on the strong arm of a young Timorese, wondering whether to be more worried about Ahasan, husband and father, or about the Rupiah 20 million that I know he has tied around his waist.*

In the January floods the bridge between the Maliana office and the Cailaku operations area washed out, as did two sections of the road a month later. Infrastructure in Timor is poor (that is an understatement!) and the rainy season cuts off many rural areas – from the programme and from the markets our clients use. But we have learned, like other programs in the wilder parts of Nepal and India, that there is usually another way around.

The complete absence of banks is a more serious problem; we carry wads of money around the countryside, in between monthly visits to the bank in Dili. We worry about the security of our staff, and look forward to the promise by the ADB Microfinance Development Project to open a branch in Maliana in 2002.

> *One of our staff and the husband of a borrower scream abuse at each other outside a centre meeting. 'I'll come to your house and cut you up like meat!' he threatens her. Scolded later for losing her cool, the staff member breaks down in tears and says, 'These are the people who killed my father'.*

There is a level of emotional volatility in Timor – a trigger point of verbal violence very close to the surface – which makes managing staff and borrowers an art which has to be learned. It is partly the culture – Timorese seem closer to the more direct and confrontational Pacific cultures than they are to Asia. It is also an outcome of the violence visited on Timorese for a generation and the horrors of 1999, when Timorese militias, funded and directed by the Indonesian army, killed and destroyed the homes and livelihoods of the majority who favoured independence. Independence itself has given rise to unrealistic expectations and anger when these dreams are not realised. Our staff are mostly women and they are traumatised; often more angry or more frightened than the situation seems to call for. It is very difficult to discipline staff or let an unsuitable trainee go without explosions. The CASHPOR programme managers have learned to pre-empt these situations, and particularly to reassure the staff and win their support for dealing with clients in a clear and business-like way.

> *Nine members of a four group centre have almost completed payment of their first loan. One after the other they refuse to make their last payment – at first claiming that they have paid in full, and then, when shown the signed collection sheets that prove otherwise and after hours of patient explanation, still refusing to pay. This contradicts the most basic Grameen belief – that clients pay to get access to their next loan. These women are $4 away from the next loan, and they don't want it!*

We still do not fully understand what happened here. The twice a week market at which these women do business was reduced to once a week just before this happened. We made house visits and talked to the village leaders. But nothing worked for long. Staff became demoralised when only a handful of members straggled into meetings late, week after week, and more and more members joined the defaulters. At its worst, the portfolio at risk in this sub-district rose to 28 per cent.

Families in Cailaku grow most of their own food and the area supports only two weekly markets. Many of our clients there had not done business before. Except for ploughing, there seems to be little need for capital to invest in farming. Given this environment, we gave too many maximum loans ($100) to too many women too quickly. The village market was flooded with *Moris Rasik* clients all selling the same five items. In addition, in the village with the problem centres, the political leader was against the programme. A lot of poor women paid for our mistakes, of course. Some 22 completed paying their loans and dropped out, not wanting to try again. We have 62 defaulters. We finally closed both the centres. In October, the Board decided to write off the remaining balances of 47 defaulting clients from these centres. So we did not, in fact, rehabilitate the bad centres in Cailaku. At best, we stopped the rot from spreading. Out of 235 members recruited in Cailaku over the year, we retain 140, a dropout of 40 per cent. Nearly half are on their second loans and their repayment is satisfactory. We have opened two new centers and they are slowly growing.

We then drowned out the Cailaku problems by opening a new branch in a mountain area, which grew rapidly and has maintained perfect repayment. Dropout so far is zero. This growth – and the write-off – has brought our portfolio at risk down to 0.1 per cent by the end of February 2002. Bobonaro sub district has very little paddy and families have to trade to survive. Girls as young as 13 travel around the village markets and many women also make *tais* (a woven cloth) for sale. Bobonaro is a center for animal trading. But economic opportunity and skill in business is only half the Bobonaro success story. The other half is the leap in the capacity of our Timorese staff. They learned important lessons from Cailaku and went to the new branch determined not to let it happen again. And nobody was more determined than Norbaiti Rahmat, the new Programme Manager from Amanah Ikhtiar Malaysia, who was still struggling with culture shock when she had to confront this repayment crisis. Her current rapport with staff and clients, and her hands-on, patient and tireless training of the staff, has been crucial to our success to date.

By February this year, a new batch of field staff with two month's training behind them, were forming new village centers in Zumalai, in the Covalima district. Families in this district are as poor as I have seen anywhere in Asia.

Disappointments

We have one big failure. We have 17 field staff, some of them very good indeed; but we do not have a single Timorese manager. We have had no less than seven management trainees, part graduates from Dili, and they have all gone back to Dili. No full graduates have volunteered to work in offices with no electricity, not much water and a lot of tough field work. Timor has few graduates and those few have plenty of opportunities with the new government or with international NGOs based in the capital. They do not have to look for work in places like Lourba. How can we build a sustainable program, managed by Timorese, if we can find no Timorese managers to train?

A year of training effort and disappointment leads us to one conclusion. We have to go with our field staff. Several of them, in a more developed or more equitable system, would have gone to university. But they are working with *Moris Rasik*. They have the necessary intelligence and initiative. They come from the sub-districts and speak the local dialects. They accept the tough conditions there as normal. They are better than our Dili trainees at managing our rural women clients.

We have already selected three of them, all women, to head the three branch offices. We call them 'units' as they are smaller than the normal Grameen branch because of the terrain and the relatively low population density. This year we begin a systematic training program to groom the most promising field staff to become unit leaders, district-level supervisors, accounts officers, and training officers. Since these staff have no English, we will try to work with Amanah Ikhtiar Malaysia and with Mitra Karya in Indonesia to send trainers to Timor and to take our staff for field training. (All the staff are educated in Indonesian, and Malay is basically the same language.) It will cost more and it will take longer than in other MFIs. But after several years of education in this '*Moris Rasik* School of Business Management' our best field staff will graduate into microfinance managers.

Key lessons and challenges

That everything will come at a higher cost and take more time than anticipated have been the key lessons that we have had to learn in our first year. We have to accept that we are operating in a post conflict situation and that our greatest challenge is overcoming the scarcity of human resources in that environment.

[1] Helen Todd is Managing Director of Moris Rasik, which is a term in the language of the Timorese meaning 'independent and dignified life'.

Microfinance and poverty alleviation: The dangers of a development 'snake oil'

Patrick Kilby, National Centre for Development Studies, Australian National University

Introduction

The current popularity of microfinance among official aid donors, including the World Bank and more recently the Asian Development Bank, sometimes gives the impression that providing very small loans to the poor is somehow new, and, secondly, that microfinance is a panacea which will empower the powerless and end poverty. Unfortunately, it runs the risk, like many development fashions of the past, of being seen as a cure to all development ills.

Microfinance, like most other development activities, works best when it is part of a broader multifaceted approach to poverty alleviation in which a number of other structural impediments that the poor face, such as a lack of health, education, and infrastructure services, are also addressed. In practice, however, microfinance is often treated as a stand-alone activity. This paper attempts to put contemporary microfinance issues in perspective. It outlines the key debates in microfinance around poverty alleviation outreach, women's empowerment, and the use of subsidies to ensure the poor are the primary beneficiaries.

It can be argued that microfinance is not new. Traditional savings and loans schemes include intergenerational and spatial loans of livestock among nomadic herders in the Sahel of Africa; and the accumulation of savings through dowry, jewellery, or even credit through the village moneylender. Microfinance in all its forms serves to smooth consumption 'lumps' and reduce economic vulnerability, particularly of people who are living on the margins of society. It can also lead to greater economic security of the household as well as capitalising on, and gaining economic leverage from, the skills that individual households may have or can obtain.

The impact of microfinance on poverty

After more than 20 years of sustained support from NGOs, and a decade of official donor investment in microfinance, what are the results? A review of the literature shows that the impact and outcomes of microfinance programmes on the poor, are mixed. In Bangladesh where there has been a large input of external funds for microfinance over some years a number of studies show that the impact of microfinance on the incidence of poverty is at best ambiguous.

For example, Khandker (1998) found that there had been an increase in household incomes which were a direct result of microfinance programmes. However, in another study using Khandker's own data, Morduch (1998) found that the income effect was due to mistargeting of the microfinance programme and that the perceived increase in incomes was due solely to those already above the poverty line who had managed to access the programme. Khandker had made the mistake of assuming the target group were all below the poverty line when, in fact, this was not the case. Other conflicting evidence as to the income effects of microfinance has resulted in uncertainty as to whether microfinance has any effect on poverty measured in monetary terms. What is agreed, however, from most studies is more prosaic, and that is that microfinance reduces variability of income over time within households. Participants join microfinance programmes because of the reduction of the risk to household livelihoods that cheaper loans bring (Zaman 1999:4).

Likewise, if poverty is looked at in sociological terms using Amartya Sen's (1999) notions of poverty being related to a lack of entitlements and individual choices, then the studies of the impact of microfinance also identify mixed results. On the one hand, some have found that it is not empowering for women clients, arguing that such programmes increase women's burdens: they often do not control the loans, but are held responsible for them; their workloads increase; and there is increased pressure on them from within the families and from microfinance institution staff. These outcomes have the paradoxical effect of reducing the choices available to women rather than enhancing them (Goetz and Gupta 1996, Mayoux 1995, 2001, Rahman 1999).

On the other hand, there are a number of other studies, such as Pitt and Khandker's, which found that not only were households that received loans better off, but also that women's preferences in household consumption patterns indicated increased decision making by women (quoted in Kabeer 2001:65). Likewise, Hashemi and others (1996) found that, on eight indicators ranging from increased mobility, making independent purchases, through to political and legal awareness, access to credit had a positive impact on empowerment, while Mayoux (1999), looking at microfinance programmes across Africa, found a similar range of results.

Kabeer, in analysing the extent of seemingly conflicting results, argues that both the positive and the negative sets of findings are valid. She makes the point that the different conclusions reflect the different assumptions of power relations in households that inform each of the studies. She argues that the negative evaluations tend to underestimate the level of cooperation within households, while the positive evaluations tend not to privilege individual behaviours or choices as empowerment:

> . . . in the final analysis, the plausibility of one or other set of conclusions about the transformatory impact of credit for women will rest on the credence attached to the models of power which inform the analysis. (Kabeer 2001:67)

Kabeer goes on to argue that, while many microfinance programmes are often loaded with unreasonable expectations, purposive interventions can direct resources to women which may lay the groundwork for them to tackle other aspects of injustice in their lives (2001:83). Are there characteristics of some microfinance programmes or other interventions which provide better opportunities for this process to occur?

Given the sharp differences from studies on the impact of microfinance and the substantial resources being put into the sector, there is considerable pressure for programmes to show unambiguous impacts on the very poor. If this is not shown to be happening, it is difficult for donors to use grants or heavily subsidised funds for these programmes which generally have a specific poverty alleviation objective. From a practitioner perspective it is difficult to be cost-efficient in reaching the very poor compared to other client groups. This is because of the relatively high transaction costs of the smaller loans that the very poor require, their reduced capacity to manage finance, and the fact that they are seen as higher risk. Logically, microfinance to the very poor must involve the use of subsidies, but still much of the microfinance debate centres around whether subsidies should be paid, to what extent, and how they should be phased out. The subsidy debate raises the question of the efficiency of microfinance programmes, while the poverty debate outlined above relates to their effectiveness.

Sustainability and risk management: The use of subsidies

At the heart of the subsidy debate is the issue of sustainability. At one level we can look at the institution in terms of operational and financial sustainability, or at the sustainability of the loans themselves in terms of social impact. That is, are the lives of the clients irreversibly changed? Is poverty being reduced? Are incomes being stabilised? Would the community-based group maintaining or administering the loan continue if the intermediary microfinance institution were not there? In practice, much of the current debate on microfinance tends to focus on the intermediary institution, and how it should be financed or subsidised. This is where the efficiency–effectiveness debate comes to a head.

It is almost axiomatic that if the very poor were to be reached, then the best that could be hoped for is operational sustainability of the programme. It is very hard for sufficient income to be generated from fees and interest charges, which the very poor would pay, to cover all of the institutional costs. As a result some advocates of the micro-banking forms of microfinance take the view that the focus should move away from targeting the very poor to what they call the ‘entrepreneurial’ poor. While this is valid from a commercially based micro-banking perspective, from a development perspective this approach can involve leaving out up to one-quarter of the population of most poor countries, and so call into question the use of poverty-targeted aid funds to subsidise what are commercial financial operations. The question remains of how subsidies should be used to ensure a greater reach of microfinance to the very poor.

Due to the highly political debate around the issue of subsidies, they tend to be hidden, often in a cloud of anti-subsidy rhetoric. Morduch’s (1999) study of the Grameen Bank, for example, found an effective subsidy level of $US15 per member per year. If that subsidy were to be removed, the bank’s target group would have to shift away from the very poor through its having to charge higher fees and interest rates to cover costs. Padmanabhan (2001:494) found that, using the Subsidy Dependence Index, some microfinance operations had an index as high as 1,146 per cent, and that less than 20 per cent of most operations had any hope of reaching financial sustainability, with the very poor as the main target group.

Another form of subsidy is the time spent by the facilitating institution, whether it be a specialist microfinance institution or an NGO, in capacity building with local groups. In order to reach the very poor and marginalised, it may take about twice as long for a microfinance programme to reach operational sustainability than when targeting the not-so-poor (up to 10 years, versus 3–5 years for the not-so-poor).

This discussion of subsidises raises the question as to why there isn’t a more open recognition that subsidies are required if there are to be transfers within and across sectors of society to reach equitable outcomes of access to services, employment, and other livelihood opportunities. This does not mean that artificially low interest rates should apply or that high repayment rates are not demanded. Both artificially low interest rates and low repayment rates will ultimately result in the erosion of the poor’s savings. But it does mean that microfinance institutions should look at their target group and consciously calculate and seek subsidised or grant funds to cover the costs in reaching these groups, rather than ignoring them.

Models of microfinance

Are there models of microfinance which lend themselves to a greater poverty reach? Linda Mayoux (1995:2) has identified two broad models of microfinance: the market model, and the empowerment model. The market model is a credit-driven model which has a reduced emphasis on client savings, except as security deposits against loans. This model has a focus on discipline and includes strong enforcement measures for compliance, including peer pressure (group members cannot get loans until all loans to the group are up-to-date), and pressure from the intermediary institutions, including legal sanctions. It provides little opportunity for client participation, or for group self-management or autonomy. Microfinance staff are the primary point of accountability (Rahman 1999). Mayoux (1995:6) argues that it is weak in reaching the very poor as it depends on very high on-time repayment rates, has high transaction costs, and little involvement of clients in decision making. It is also arguably less cost effective in providing very small loans to the very poor for their priority needs, which tend to be consumption. The often-draconian enforcement provisions tend to discourage those who are vulnerable and risk averse.

The empowerment model is a based on a mutual or self-help approach pioneered in India in the early 1980s. It involves small groups of women who collect their own savings and revolve them as credit among their members. These savings are often supplemented by external credit injections from banks or other institutions. This model is based on high levels of group ownership, control and management. The staff of the microfinance institution are more removed from individual clients, as they relate to groups rather than individuals. This model has lower transaction costs than either the market approaches or those which provide loans to individuals (Puhazhendi 1995). In addition, this model is far more reliant on members' own savings for loan capital, which in turn provides a greater sense of equity for the group members.

The advantages of the mutual model is that there are opportunities for people to save and accumulate lump sums for specific purposes (rather than to borrow externally), which suits certain groups such as indigenous or tribal people who prefer to avoid accruing personal debts outside their particular clan. Also, benefits stay with the group, with surpluses being distributed or re-invested to group members, rather than used for the expansion of the microfinance institution. As the users/savers have a greater equity in the institution, they have more ability to set policy and rules to adapt to changes in local livelihood needs or to adjust to external shocks, rather than being dictated by the external capital sources' rules. Mayoux argues that the very process of taking decisions within the group is an empowering process and so can lead to broader development outcomes, such as the greater participation of women in local government processes, and so on. My own research in India also indicates that an accountability relationship of the microfinance institution to the group likewise is an empowering process. Unfortunately, outside of India there is little large-scale promotion of these self-help mutual models, mainly because (it would seem) they are savings driven rather than credit driven.

It can be argued that, in terms of poverty reach, the mutual model provides greater opportunities. However, it is not conducive to rapid expansion, as it is savings rather than credit driven, and it has high institutional costs in start-up that in effect are a cost to the donor, which to many would be seen as a subsidy. Also, these models because they are less disciplined and more decentralised are harder to regulate and monitor, and so represent a greater risk to the donor.

Conclusion

The key to this debate is that any anti-poverty programme will involve transfers, and if the very poor are to be included in microfinance programmes, models must be adopted which suit their needs and capabilities. It must also recognise that poverty is a lack not only of monetary resources but also of what is increasingly being termed 'social capital', and the opportunity for individuals to make choices around their own and their family's future. Achieving these outcomes is not easy and requires multifaceted approaches not only in microfinance but also in the broader social development with poor communities. Microfinance should therefore not be seen as a 'magic bullet' for poverty reduction but, rather, as being able to make at best a modest contribution. Its impact will depend to some extent on the model adopted and the resources in terms of time and money provided by donors, either local or international.

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Grant-based approaches to microfinance

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Within the past few decades the number of programmes that provide small-scale finance to the poor has increased dramatically, and these programmes have been acclaimed as contributing to poverty reduction (Johnson and Rogaly 1997:1). Microfinance has almost exclusively been provided in the form of loans; very few programmes have used grants. Yet many small businesses established in developed countries rely on some form of equity capital to fund business start-ups. The success of start-up grants and equity financing in developed countries suggests that this method of microenterprise finance might also be applicable in developing countries. In some situations, grants may be superior to credit programmes.

Micro-grants are comparable to venture capital in that the decision making process, about whom to fund, is similar in both cases. Both venture capitalists in the developed world and grant-giving agencies in developing countries aim to target their support to entrepreneurs who are likely to succeed in business. Unlike venture capital, in which the financier receives a share of the enterprise's profits, grants provide capital to potential entrepreneurs in developing countries without any expectation of a share in the ownership or profits of the business. Instead, grant agencies seek to increase the social equity of the local community and its sustainability and independence from continued overseas aid.

The advantages of grants include reduced risk to the borrower (because no repayment is required) and reduced transaction costs to the donor. Given these factors, grant-based finance is often able to reach the poorest members of the population.

Financing microenterprises

Microenterprises typically have one to five employees, are unregistered, and do not pay taxes. To be successful, microenterprise entrepreneurs must have training, capital, and risk management ability. They must possess managerial skills, knowledge of markets and prices, and the technical ability to create their product. Simple vending businesses require general managerial skills but little technical ability, whereas manufacturing businesses, such as furniture making, need an additional knowledge of the craft. Entrepreneurs must also have sufficient capital to finance the start-up costs of the business, plus access to additional capital to fund further growth. As the economists Matthew Sonfield and Robert Barbato (1999:3) have noted, 'it is the lack of capital that most frequently keeps a person from becoming self-employed'. Furthermore, entrepreneurs need the ability to manage risk so that they can minimise potential failures. All three of these issues must be addressed if the business is to be successful and is to provide an income for the entrepreneur and his or her family.

There are several possible sources of capital that the poor can theoretically access to fund a microenterprise. One is *self-financing*. In a self-financed business, the owner saves his or her own earnings or borrows from relatives. This is not always possible, because the poor, living on a subsistence income, may be unable to save. This is especially true in times of natural disaster or social upheaval, when many people have lost all of their assets. Even among the poor who can afford to save, a lack of savings institutions makes savings difficult (Otero and Rhyne 1994:28).

A second possible source of capital is local *moneylenders*. The poorest and most vulnerable borrowers often have little or no collateral to put up for a loan, which increases the risk to the lender. For this reason, moneylenders will often refuse to lend to the very poor. For example, Graeme Buckley (1997:1084) observed that, in Malawi, 'there was a general feeling that moneylenders would not lend to the poorest members of a community but only to those who could offer some form of surety such as a member of the family with a wage income or a particular asset'. Moreover, moneylenders' interest rates are often prohibitively high, making them an undesirable source of credit for many.

A third possible source is *commercial banks and other lending institutions*. These are problematic for the very poor. Lack of collateral, the need to be near a bank branch to access services, and the inability of the poor to assume the risk of repayment if the business venture fails are three reasons why the poor often cannot access formal credit. Commercial banking barely penetrates most rural areas (White and Killick 2001:69). Even if the poor own land, it is often not possible to use it as collateral, because of ambiguous or unrecorded traditional title or because of regulations prohibiting its use as collateral (Yaron and Benjamin 1997). Many people cannot assume the risks that borrowing entails. Banks and other lending institutions are therefore often not the best source of capital for the very poor.

A fourth form of finance is *microcredit institutions*. These institutions will often make loans to clients rejected by commercial banks, and there is normally little competition between microcredit institutions and commercial banks (Zeller 1994). The principal advantage of financing through microcredit programmes is that they are willing to loan small amounts to first-time or less creditworthy borrowers, and sometimes to those lacking collateral. Yet microcredit institutions face some problems. In particular, they may not reach the poorest of the poor, given their need to sustainably finance themselves through cost recovery (White and Killick 2001:69). The high interest rates, typically 15–30 per cent a year, are often unacceptable to impoverished potential borrowers because they cannot assume the risk of repayment.

Limits to microcredit

Loan-based programmes face a number of potential problems. A serious one is the potential for loan default if business income declines or if the business fails. Johnson and Rogaly (1997:11–12) and Hulme and Mosley (1996:120–2) note that the very poor have a limited ability to assume risk, and that the poorest borrowers may become worse off because of business failure. The seizure of assets, and suicide, are just two of the potential crises stemming from inability to repay loans. In several well-documented cases concerning the Grameen Bank in Bangladesh (see Goetz and Sen Gupta 1996, Rahman 1999), borrowers have had to recycle loans to make payments (often by borrowing from moneylenders), have had to sell household assets or their own food supplies to make payments, or have had to leave their home village for an urban area in order to find wage labour to repay their loan. Women do not always benefit from such microcredit programmes because they are often forced to assume loans for the benefit of their male relatives. And Anton Simanowitz (1999:177) notes in his study of South Africa:

> The fact that good credit discipline provides entitlement to further loans acts as a strong incentive for members to borrow money to repay the loan, in the knowledge that they will be able to pay off the credit with the next loan. In this situation, credit will serve to create indebtedness and dependency.

Microcredit institutions may have difficulty in reaching the poorest members of society because most of them conduct the bulk of their work in urban areas, where loan clients are concentrated in close proximity, lowering the costs of monitoring and collecting loans. Yet a high proportion of poverty in most developing countries is rural. The cost of delivering financial services to remote rural areas is much higher, and often too high to make a microcredit institution operating on a cost-recovery basis viable.

Another underlying problem with loan-based programmes is the conflicting goals of the programme: on the one hand it is to provide universal credit to the poor, but on the other hand it needs to be profitable to continue its existence. Many programmes attempt to avoid this conflict by making larger loans to creditworthy borrowers, while denying credit to the very poor and unknown. Hulme and Mosley (1996) note that financial benefits disproportionately accrue to the middle poor and do not reach the poorest. The high repayment rates claimed by some agencies may be a reflection of this process. Johnson and Rogaly (1997:12) note that, with respect to microcredit programmes, their 'appropriateness as a strategy for poverty reduction in the case of the poorest people is questionable'

Grant-based microfinance

Grant-based finance can successfully address some of the inherent problems of microfinance. Like equity financing, which is a common source of capital for most enterprises in Western industrial countries, grants need not be the exclusive source of start-up capital for a microenterprise. Most high technology business start-ups have as little initial access to bank loans as do many of the poor in developing countries because they lack the same requirements, such as credit history and collateral. Therefore many business start-ups look to venture capitalists who agree to share the risks as well as the rewards.

Grant financing provides reduction of risk and lower transaction costs. With lowered risk, the poor can consider adopting innovations that might prove too risky if financed through borrowed capital. The transaction costs of small grants may also be lower than those of small loans, because processing and collecting a small loan takes a great deal of time but does not generate much revenue. Lenders therefore tend to focus on larger loans, where the transaction costs as a percentage of the loan are smaller. The cost of processing and collecting a large loan is essentially the same as for a small one, but the returns are much greater on a large loan. Grants avoid the cost of collection entirely and also minimise processing costs, because the recipient's credit history does not need to be thoroughly researched. Grants also create creditworthiness for the entrepreneur. An established business, after initially being started with a grant, stands a much better chance of qualifying for credit than does an unknown start-up.

A grant creates a partnership between the entrepreneur and the donor, both of whom have an interest in the success of the business. In the case of venture capital firms in developed countries, the interest of the financier is in showing a financial return on his or her investment. In the case of a grant-making agency in a developing country, the interest is in developing the community's social equity: the desired goals of sustainability, economic development, the generation of new products and services, and other community benefits. Donor organisations, such as the Village Enterprise Fund, an American agency operating in East Africa, and the Trickle Up Program, which operates worldwide, have successfully used grants to help finance thousands of small businesses. These microenterprises provide employment and supplemental cash income for some of the poorest residents of rural areas.

The greatest obstacle to grant-based microfinance is the long-term sustainability of the grant-making agencies. As these agencies do not recover the sums they transfer to microenterprises, they rely on a continual stream of donations from individuals in developed countries. Though the long-term existence of agencies such as the Village Enterprise Fund and the Trickle Up Program cannot be guaranteed, their continued ability to expand their grant programmes suggests that they are able to sustain themselves through fundraising and new donations. It should also be borne in mind that many of the recipient microenterprises are themselves sustainable. For example, about half of the microenterprises financed by the Village Enterprise Fund have remained in business for more than four years.

Grant-based forms of microfinance fill a niche largely ignored by microcredit agencies by helping to mitigate the risk of start-up businesses and by contributing to the social equity of a community. In filling this particular niche, grants complement, rather than compete with, microcredit programmes. Ideally, grant- and loan-based programmes will work in tandem to offer a complete spectrum of financial services – geared to differing needs – to communities in developing countries.

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