Microfinance in Africa

Sasakawa-Global 2000

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Sasakawa Africa Association, Mexico City, 1999

ISBN 2-940200-05-X

Sasakawa Africa Association, c/o CIMMYT, Apdo. 6-641, 06600 Mexico D.F. Mexico

Global 2000 Program of The Carter Center, 1 Copenhill Road, Atlanta, GA 30307, USA

The Sasakawa Africa Association (SAA) and The Carter Center are joint sponsors of Sasakawa-Global 2000 agricultural projects in sub-Saharan Africa. The primary aim of the projects is to promote more effective transfer of improved technology to small-scale farmers. SAA was established in 1986 by the Nippon Foundation, Tokyo (formerly the Sasakawa Foundation); Global 2000 was set up in the same year by The Carter Center, Atlanta Georgia, USA.

Correct citation: Breth, Steven A., ed. 1999. *Microfinance in Africa*. Mexico City: Sasakawa Africa Association.

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Foreword

For over a decade, Sasakawa-Global 2000 has focused on introducing modern technology to the smallholder farms of sub-Saharan Africa by training extension workers and farmers. The work of SG 2000 has demonstrated that small-scale farmers of Africa are willing and able to adopt modern inputs in their quest to raise productivity and incomes. The payoff for those who shift to improved seed, inputs, and better practices has been dramatically higher yields and incomes. Greater output of staple food crops allows farmers to diversify by expanding production of cash crops and livestock. And it lowers the cost of food, benefiting nonfarm families. At the same time, the rising demand for supplies, services, and consumer goods stimulates the rural economy.

The availability of agricultural credit is one of the essential pillars of support for new production technology. Commercial farmers the world over borrow to finance crop production costs and to enlarge their production base by acquiring tools, equipment, livestock, and facilities. But in Africa, the formal banking system has not found a way to serve small-scale farmers who need relatively small amounts of capital—causing high transaction costs—and usually lack land titles or other conventional collateral.

In recent years, however, a number of institutions dedicated to giving low-income people access to credit—the Grameen Bank in Bangladesh, famously—have shown that microfinance is a viable and vital service for the poor, at least for certain types of enterprises. In Africa, the experiences of microfinance institutions launched in the last decade are offering new hope about the possibilities of achieving financial sustainability while serving the least-advantaged members of society on a larger scale.

This book explores recent developments in microfinance in Africa. It is divided in two parts. Part 1 contains selected papers from the Microfinance Professional Forum held in Cotonou, May 18–20, 1998. The forum was jointly sponsored by the Sasakawa Africa Association and the World Bank. Part 2 contains case studies of several African microfinance institutions prepared by the World Bank. These studies are adapted from reports issued in the World Bank's Sustainable Banking with the Poor Series.

Thanks go to Marcel Galiba, Bernadin Glehouenou, Fidele Ndayisenga, and Herv Akueson of SG 2000 and Cécile Fruman and Laurance Hart of the World Bank for their efforts to organize of the Cotonou conference. SG 2000 is also grateful to Cécile Fruman and Korotoumou Ouattara of the World Bank for their help in assembling and reviewing the case studies published here. Last, but not least, thanks goes to Steven Breth who edited this volume.

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Abbreviations

ABA	Alexandria Business Association
BCEAO	Banque centrale des États de l'Afrique de l'Ouest
BNDA	Banque nationale de développement agricole
CCCE	Caisse centrale de coopération économique
CFA francs	Communauté financière africaine francs
CFD	Caisse française de développement
CIDR	Centre international de développement et de recherche
CIRAD	Centre de coopération internationale en recherche agronomique pour le développement
CLCAM	Caisse locale de crédit agricole mutuel
CNCA	Caisse nationale de crédit agricole
CPEC	Caisse populaire d'epargne et de credit
CRCAM	Caisse régionale de crédit agricole mutuel
CVECA	Caisses villageoises d'épargne et de crédit autogérées
DNACOOP	Direction nationale de l'action coopérative
DOI	Depth-of-outreach index
FECECAM	Fédération des caisses d'épargne et de crédit agricole mutuel
FY	Fiscal year
GAF	Get Ahead Foundation
GAFS	Get Ahead Financial Services
GDP	Gross domestic product
GNP	Gross national product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
KfW	Kreditanstalt für Wiederaufbau
K Sh	Kenya shilling
MIS	Management information systems
MTDP	Medium-term Development Plan
NGO	Nongovernmental organization

PARMEC	Programme d'appui à la réglementation des coopératives et mutuelles d'épargne et de crédit
PPPCR	Projet de promotion du petit crédit rural
R	Rand
ROSCA	Rotating savings and credit association
SBP	Sustainable Banking with the Poor
SDI	Subsidy dependence index
TPCF	Tout petit crédit aux femmes
TSF	Technical Secretariat of the Federation
UEMOA	Union économique et monétaire ouest-africaine
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
USAID	U. S. Agency for International Development
WOCCU	World Council of Credit Unions

Part 1. Papers from the Microfinance Professional Forum, Cotonou, May 18–20, 1998

Overcoming Credit Access Barriers

J. D. Von Pischke

Credit is available to almost everyone. Even children lend and borrow playthings among themselves. Informal financial relationships include most of the population in every country, excluding only those with poor character or extreme inability to function economically. Kinship and friendship credit is widely available. Credit from suppliers or customers is used by many businesses. Moneylenders of various sorts are common in developing countries, as are rotating savings and credit associations (ROSCAs) such as the *tontine, djanggi,* and *esusu* in West Africa.

Why, then, the widespread concern among development specialists, NGOs, and politicians about alleged barriers to credit access? A short answer is that these promoters generally consider credit to be an instrument useful for energizing the causes or purposes that they advocate. They also believe, correctly, that credit can expand opportunities and contribute to economic welfare. This contribution occurs through the informal channels and also through formal arrangements based on assets. Formal credit is obtained against assets used to collateralize loans and, more important, against projected future cash flows. Of special interest is free cash flow—the amount that a prospective borrower would have available to service debt after the borrower's other obligations and objectives have been taken care of. Credit, successfully used, enables borrowers to obtain and use more productive assets, further increasing their cash flows and repayment capacity.

From this perspective the fundamental issue is the quality and quantity of credit, which is the subject of this paper.

Frontier of Access to Formal Finance

Credit access can be illustrated by the metaphor of the frontier of finance, defined as the limits of financial intermediation by formal institutions, i.e., those incorporated under government laws. Beyond the frontier lie those parts of the legitimate economy that are not considered creditworthy by formal financial institutions. Inside the frontier lie those parts of the economy that have access to formal finance. Likewise there is also a frontier in savings and money transfer services. Small savers may be spurned by formal intermediaries that require high minimum balances and high minimum transaction sizes. Money transfer services may be too expensive for those wanting to send small amounts over long distances. In short, the frontier is defined by barriers to access.

J. D. Von Pischke, a former World Bank staff member, has written widely on financial market development, rural credit, cooperative finance, and industrial finance.

While informal finance reaches more people, formal finance can operate on a larger scale, measured by the volume of lending. The largest contribution that formal finance makes to the economy is integration of markets for all kinds of goods and services, promoting efficient allocation of resources. It is also controlled to some extent by government for purposes of national economic management as well as for political ends. Abuse of formal financial markets by officials and by governments is not uncommon because finance is so easily controlled.

Role of Failure in Successful Design

What strategies can be used to decrease barriers to credit access? Many have been tried by the governments of developing countries and by development assistance organizations since the 1960s. Most strategies that tried to work against market forces and that were implemented by direct intervention have failed to be sustainable. An example of a flawed strategy is artificially low interest rates, which debilitate financial intermediaries and create great incentives for capture of these funds by those who are better off and hence better able to gain access because of their social, economic, and political status.

A related area of failure is directed credit, which attempts to channel credit to specific target groups or for specific purposes such as fertilizer application, dairy production, or small manufacturing firms. This strategy has frequently failed the sustainability test because of too much emphasis on promotion, too much subsidy, and too little attention to risk and incentives, as well as because of the fungibility of money.[1]

A third related problem has been the indifference of project designers to the challenge of institutional sustainability. This neglect has generally arisen from a narrow economic approach, a social-work orientation, or the political desire to "do something" to address a particularly pressing or politically defined problem. (Political purposes are usually accomplished by loan disbursement, after which interest often fades rapidly.) These approaches and motivations ignore the technical requirements for sustainable intermediation, such as good management information systems, procedures for analyzing risk, and strategies for controlling costs and for pricing services so that a financial institution can survive and prosper. Institutional survival is also captured admirably by the new institutional economics, which focuses on information problems, on the incentives created for all stakeholders, and on screening, monitoring, and enforcement.

The lessons of failures in the recent past should be reviewed and remembered only because success never offers complete lessons. Finance involves risk, and development requires innovation: failure is therefore likely to occur from time to time. The best failures are those that occur in ventures based on the best information available at the time they were launched, and those that occur only once. In this sense and in the long run, the only things worse than failures is having none or ignoring the lessons of experience. In this respect, donors often appear to have short memories.

Why Sustainability Matters

Sustainability is important because borrowers usually place an extremely high value on continued access to credit. Many promoters believed that a one-shot intervention in the form of a single loan would be sufficient to liberate borrowers from poverty, establish a new type of activity such as smallholder commercial farming, or create a viable small-scale industrial sector. This strategy failed because many economic activities capable of growth benefit most from continued access to credit. Also, the one-shot assault on the frontier created few incentives for loan repayment. Failure to recognize these aspects resulted in lots of money being wasted.

Unsustainable lending programs create bad incentives. If borrowers suspect they will not be able to obtain new loans because the lender will close or the program will disappear, they have little motivation to repay. Their failure to repay in turn ensures that the program will not be sustainable.

The sustainability criterion is very demanding. Officials of the Consultative Group to Assist the Poorest estimate that there are 7,000 providers of microfinance around the world. They further indicate that 1 percent of these appear to be sustainable at present and that another 3 percent have the potential to become sustainable. A positive aspect of these otherwise discouraging statistics is that that 1 percent have a disproportionate market share of the microfinance industry and that the 3 percent also tend to be larger than average.

Public policy is by definition the use of official funds and power. In view of the lessons from recent history noted above, what constitutes responsible government performance? Public policy that promotes broader and deeper credit access is responsible only if its central focus is on the creation and promotion of sustainable institutions and on continued access to credit by those who are identified as target beneficiaries. Efforts not animated by these concerns are essentially charitable ventures, and should be promoted on that basis, or simple political patronage to buy votes, which is questionable public policy.

One particularly unfortunate tendency of conventional public policy initiatives at the frontier has been created by the willingness to use the economic concept of market failure as a justification for intervention. Market failure is said to occur whenever information problems inhibit the realization of economic efficiency and social gains or when the private and social costs and benefits of a desired activity or outcome diverge so that private action is insufficient to produce an optimum amount of the desired good or service as defined by this approach to economic theory.

Market failure is a public policy wild card, providing a basis for almost any intervention: information is always insufficient and private and social costs and benefits are likely to diverge to some extent. Basing intervention in finance on these possibilities entertains an internal, circular fallacy. Those intervening also have information problems: e.g., what is an efficient price for these loans, how large should they be, and over what period and through which means should they be recovered? What delivery mechanisms or institutional forms are most likely to succeed? Likewise, equation of private and social costs is subjective, and hence prone to manipulation. Intervention is unlikely to be transparent, especially if policy makers are not greatly accountable. Benefits are touted while costs are rarely measured.

[1] Fungibility is demonstrated when the activity added by the borrower at the margin of his or her economic activity is not identical to the purpose for which a loan is provided, or when the borrower receives a loan for an activity that would have been undertaken without the loan. When loans are available for certain purposes only, fungibility works against increased productivity in the areas to which they are targeted. For example, if loans are given for maize seeds and fertilizer, and this is the cheapest loan a maize farmer can get, the farmer will apply for a maize loan whenever his or her household wants extra money.

Interventions in the form of credit programs or facilities based on allegations of market failure appear to have failed to produce a single viable credit project or institution. They have, however, permitted those with power and money who are not active in financial markets to impose their values, at least for a time, on those who are.

A related concept that leads to a dead end is "meeting credit needs." This objective fails to direct energy efficiently because credit needs are subjective. They are always larger than the volume of credit, and possibly infinite. They have nothing to do with repayment capacity or the intention to repay. Need ignores risk and hence disregard costs, providing no guidance on loan pricing. Credit needs are a politically defined map with no fixed reference points. "Meeting credit needs" does not provide a basis for creating welfare gains in poor countries.

What Is Sustainability and What Does It Require?

Sustainability in financial services has several definitions. The most widely debated is independence from subsidy. This does not mean that no subsidy is justifiable; rather, movement away from subsidy dependence is required within a reasonable period. Ten years may be required to create a competitive financial institution, providing a horizon for independence from subsidy. Another definition is simply that a sustainable lending institution or loan portfolio has a positive net present value. This does not assume that eternal life is required—nothing lasts forever—but simply that funds invested in a credit program are recovered with a gain at least equal to the opportunity cost of capital.

Emphasis on sustainability is a fundamental part of any strategy to shift the frontier of finance. Within this framework, the task is to generate the greatest number of constructive opportunities for entrepreneurs and policy makers. This requires options that are simple, effective, and relevant. Simplicity is required to keep transaction costs low and subsidies transparent. Effectiveness is necessary to ensure goals are achieved. Relevance is required to focus energy on real problems and their solutions and to minimize costly unintended effects. From the perspective of sustainability, technical problems rarely have political solutions; political problems likewise have few, if any, technical solutions.

Creating Debt Capacity

Efforts to move the frontier require a broad, inclusive organizing concept capable of integrating all aspects of this challenge, providing the greatest space for creative, innovative responses. The only concept that achieves this is debt capacity and its creation. Debt capacity is the amount that any person, household, firm or other economic entity can borrow on a sustainable basis. Here, "sustainable" refers to the ability to service debt as envisaged in the loan contract, within an environment that rewards faithful adherence to debt contracts with the promise of continued access.

Debt capacity does not imply that persons and entities always borrow up to the limit of their debt capacity. Not all people or all entities want to borrow all the time. However, most want to be able to borrow at any time, making unused debt capacity a tremendously important asset, a basis for hope, growth, and opportunity. In fact, exhaustion of debt capacity often reflects opportunistic behavior that is not sustainable. It may also be the result of exploitation by predatory lenders. It can be promoted by public policy; on a national scale exhaustion of debt capacity can lead to deep crises, such as occurred in South Korea in 1997.

Technical Basis of Debt Capacity

Financial markets offer three, and only three, technical possibilities that increase debt capacity: lengthening term structure, reducing transaction costs, and refining valuation processes.

Lengthening Term Structure

Term structure, most simply defined, is the period, beginning now and extending into the future, for which money can be borrowed. In other words, what is the longest loan maturity that a prospective borrower can obtain? Term structure is an important determinant of loan size. Many people can borrow against their next harvest or paycheck, and loan size would presumably not exceed the value of the harvest or of the paycheck. They could obtain much larger loans, however, if they could borrow against several harvests or several paychecks because longer periods normally generate greater cash flows than shorter periods. Cash flow creates repayment capacity, which in turn creates debt capacity within the limitations of the term structure of the financial market. Less-developed financial markets tend to have short term structures. Most families can obtain 30-year home mortgages in the United States; few can obtain 10-year mortgages in Bangladesh, and these are subsidized.

Lenders must maintain a certain relationship between the term structures of their assets and liabilities. A banker using short-term funding to finance long-term loans risks liquidity problems and earnings problems. For example, a liquidity squeeze occurs if providers of short-term funds want their money back faster than long-term loans are repaid. Earnings suffer if changes in interest rates narrow or erase the spread between the costs of short-term funding and returns on long-term lending. Therefore, lengthening term structure occurs most easily when lenders can (a) obtain grants, equity investment, or retained earnings, which have no maturity, or (b) long-term debt that can fund long-term loans, either with fixed interest rates that lock in the lender's spread or with rates that can be adjusted to maintain a spread consistent with market conditions.

Lenders using long-term debt from financial markets to fund their lending operations normally have to pay higher interest rates on such funds because of the greater risk of long-term obligations relative to short-term ones. Therefore, long-term lenders must operate in a manner that creates confidence among those who lend to them. This can be very difficult when the economy is unstable or when the risks of instability are significant.

Reducing Transaction Costs

The second way debt capacity is created in financial markets is by reducing transaction costs. Transaction costs are admission tickets to financial markets—the costs of establishing and conducting financial relationships. They are incurred by all parties to financial contracts: borrowers, lenders, and intermediaries. They include the costs of gathering and processing information, including documentation of loan applicants' civil and financial status and performance monitoring; security arrangements for cash and documents; recording systems for transaction processing; queuing; and decision making.

Innovations that reduce transaction costs expand access to financial services, expanding the frontier. Of special interest in development finance is their incidence, or who bears these costs. Financial intermediaries can discourage unwanted business by increasing loan applicants' transaction costs. They can compete by reducing such costs. In many countries, queuing time is one of the largest transaction costs imposed on loan applicants and savers. Banking halls tend to be crowded, and service is slow. Many NGOs require their prospective clients to undertake training before obtaining a loan. Loan applicants may have to make several visits to a lender's office to apply for a loan and to other offices to obtain documents.

Intermediaries' transaction costs are raised when staff are members of trade unions and when overstaffing occurs. In certain banks in Kazakstan many staff positions are duplicated, in effect creating a regular team and a back-up team that has little to do unless a member of the regular team does not report for work.

An example of transaction cost reduction in highly developed retail financial markets is the recent introduction of electronic access to financial services. A large regional bank in the United States estimates that the average cost to the bank of electronic transactions by phone or computer link or at an automatic teller machine is about US$0.13. A transaction conducted over the counter with a teller at a bank branch has an average cost to the bank of about US$8. Bank branches are open several hours a day, but many electronic transactions occur around the clock at the convenience of the customer. Home mortgages in the United States are often approved within 24 hours after the borrower has provided all necessary information. Consumer and car loans are often approved in 1 hour. Access is straightforward and relatively simple.

An example of how lenders can pass costs to others is demonstrated by group credit, as practiced by the Grameen Bank and its replicators, and also by the village banking model. Group members have to incur the costs of establishing their groups and of certain screening and monitoring functions relating to loan size, access, and repayment. This permits small borrowers to obtain loans that the lenders would otherwise find much too costly to provide. An interesting aspect of these groups is that borrowers may see participation as a benefit and not as a cost. Group meetings provide an opportunity for socializing, for affirming progress and each other, and for obtaining market intelligence. Collective action is especially powerful when those involved perceive it as a benefit rather than as a cost.

Lower transaction costs can improve repayment performance. If a small borrower's transaction costs amount to a significant fraction of the value of the loan and are imposed each time a loan is applied for, the borrower has an incentive to default, keeping the money and not having to incur the high costs of getting a new loan.

Refining Valuation Processes

The third way financial markets create debt capacity is by refining valuation processes. Lenders use valuation processes to decide what constitutes creditworthiness and to determine loan size. Innovation in these processes creates debt capacity where none existed before. This occurs through the development of new financial instruments that often introduce new ways of evaluating and managing risk.

Group credit arrangements refine valuation processes by creating incentives for honoring contracts that the group creates for its members and by spreading risks. Another innovation of this type is the approach to initial loan sizing employed by microfinance institutions using the method developed by the German firm Internationale Projekt Consult (IPC). Loan size is determined mathematically by the monthly amount the loan applicant can repay without the loan, the term for which the lender is willing to lend (often 3 to 8 months), and the interest rate. Common to both the group-lending techniques and the individual basis used in the IPC model, borrowers who meet their commitments gain access to larger subsequent loans with longer maturities. Debt capacity is created as the relationship between borrower and lender progresses, providing information and constructive incentives that create confidence, which facilitates risk management.

Interesting aspects of the quest for sustainability and valuation processes are the differences between group and individual lending approaches. Group lending lowers access barriers by reducing start-up costs for the lender: some of these costs are externalized to the groups. However, it appears that over time the individual lending approach may become the more efficient alternative, providing greater continued access because it gives the lender more information about each borrower. In group lending, much of the vital information that is required to conduct credit operations effectively remains within the group and may not be perceived by the lender. However, group lending tends to dominate in very small loans, of less than US$500 for example, while individual lending techniques tend to have larger average micro-loan sizes. A progression from group to individual lending may be useful for borrowers who gain experience that enables them to expand their businesses.

Vital Roles of Confidence and Innovation

As suggested by the technical ways in which debt capacity is created, the best point of entry for designing strategies within financial markets to move the frontier is the relationship between the borrower and the lender. This focus is warranted because it addresses the fundamental nature of credit, as suggested by the Latin root of the English *credit* and the French *crédit*, which is *credere*, to believe or entrust. Above all, borrower-lender relationships require confidence.

Confidence is critical to greater access to financial services because any effort to lengthen term structure, reduce transaction costs, or refine valuation processes is innovative and therefore to some extent risky. Why would anyone want to engage in risky behavior? Speculative motives aside, risk is offset by confidence. Where risk is not balanced by confidence, no transactions occur. Greater confidence translates into better risk management. Financial markets go to great length to increase confidence. A simple example is the promise of larger future loans to good borrowers. Another is the development of management information systems and loan analysis techniques that respond to risk. A third is the evolution of procedures that reduce transaction costs and provide transparency.

Confidence is built by good performance. For example, a loan applicant's savings behavior can provide confidence to a lender. If someone saves $10 per month regularly in an account with a financial institution, it should not be difficult for that institution to offer a loan due in monthly installments of $10. Banks in Korea have offered mortgages on real estate through programs that required regular savings for 3 years. At the end of the 3 years the balance was returned to the saver, and the bank loaned an amount equal to the accumulated savings, repayable over 4 years. Savings performance constitutes valuable information for credit decisions.

Savings also provide a source of funds for lenders, especially for commercial banks. Economies of scope arise when a client uses more than one service provided by a bank, reducing transaction costs. Nonbank financial institutions, other than credit and savings cooperatives and certain specialized savings institutions, are often not legally permitted to accept deposits. This has led some microfinance NGOs to seek a bank charter and regulation by banking authorities. There is currently a trend toward regulation of micro-lenders such as NGOs, but the effectiveness and results of such regulation have yet to be demonstrated. Based on the record of bank regulation since the 1980s, which includes massive regulatory failures in the United States, Japan, France, and elsewhere, skepticism appears warranted.

Innovation, which by definition reduces costs, is most likely to occur in finance when financial markets are competitive. Lenders in competitive markets continually attempt to offer new and better services to more and more clients, reducing access barriers. This is unlikely in financial markets that are repressed by controls that keep these markets small and restricted. The argument for financial market liberalization is that it is the only means by which significant efficiencies can be achieved, expanding outreach and promoting sustainability. However, the liberalization process is difficult to manage and may not produce these results quickly. Liberalization frees interest rates, phases out credit quotas and targets set by government, and permits new entrants into financial intermediation, often expanding the variety of financial institutions. The contribution of NGOs to microfinance demonstrates how creative new entrants can be, although this example is not entirely valid because NGOs are generally not regulated and are often the creations of donors rather than of market forces. Liberalization, phases out direct controls in favor of indirect measures and government supervision of the safety and soundness of financial intermediaries, especially those that accept deposits from individuals.

Measures Outside Financial Markets Affect Debt Capacity

Financial markets do not operate in a vacuum. Their performance is closely tied to the rest of the economy and the political life of the nation or nations in which they operate. Formal financial markets reflect the fortunes of people and firms within and at the frontier of formal finance. Simplifying a little, financial market innovations work to provide more credit against a given or projected cash flow of a loan applicant or against an applicant's assets that are acceptable as collateral. Debt capacity is created outside financial markets by measures that increase cash flows or confidence or that reduce transaction costs. However, these measures will have little direct impact on formal debt capacity if the financial sector is not in a position to respond to improvements in loan applicants' cash flows or to increases in levels of confidence that permit more effective risk management.

Technological innovation in agriculture can increase farm incomes, enabling farmers to have greater cash flows that permit them to gain access to formal credit. For example, improved livestock and better husbandry can make it possible for a dairy farmer to get a loan from a milk cooperative. Greater business volume and economies of scale can increase the ability of the coop to obtain funding for better processing equipment from suppliers or from banks. The debt capacity of the coop's members as well as of the coop itself can increase as a result of the adoption of improved breeds, better management, and better processing technology.

Education, training, and agricultural extension are helpful in creating debt capacity because they increase the ability of the loan applicant to pursue appropriate productive choices and to manage risk more effectively. These effects help create confidence on the part of the lender.

Physical infrastructure can increase debt capacity by lowering users' costs. A road connecting the countryside to a market town reduces farmers' costs of bringing produce to market, which can increase farm income and improve incentives for on-farm investment to raise yields and improve quality. Irrigation greatly increases agricultural potential, which can increase debt capacity through double cropping and higher value crops.

Agricultural price policy has an impact on debt capacity. In many countries agricultural prices have been kept artificially low by government policy that favors urban consumers or that directly taxes rural producers through levies on produce or restrictions on competition in commodity purchase, storage, and export. These policies limit rural incomes and household cash flow, which diminishes the opportunities available and restricts debt capacity. Ceilings on prices of inputs, such as fertilizer, can lead to reduced supplies because dealers and potential dealers have fewer incentives to engage in the trade or to make more fertilizer available in more locations convenient to farmers. Minimum wage rates can have a similar effect by reducing the demand for labor in rural areas. Price policies favoring farmers, often found in rich countries, also create risks because they raise cash flows and land values to artificially high levels. This may make farm debt more difficult to manage, especially when subsidies are diminished and as consolidation occurs in agriculture, pushing marginal producers out of business.

Other institutional measures are also terribly important in the quest to create debt capacity. Contract law and enforcement are fundamental to the operation of formal financial markets. Contracts not taken seriously repress confidence while risk remains high and more difficult to control. This restricts the development of credit. For example, formal lending may be based largely on the value of security, which reinforces existing patterns of opportunity because such credit is available only to those who have assets, and in proportion to the value of these assets. Increasing confidence helps separate asset value and loan size by focusing on projected cash flow, lowering access barriers. In the informal sector, commercial moneylenders with full informal enforcement powers survive while offering expensive credit to a number of clients limited by the number of face-to-face relationships the lender and borrowers can create. Economies of scale are few, keeping costs high, while funding constraints also limit the supply of credit.

A detrimental impact on debt capacity occurs when credit projects fail through the accumulation of arrears. Contracts are dishonored, creating a precedent that becomes more costly to overcome as successive credit programs fail. The basis for confidence is eroded. An especially destructive measure is a government forgiveness of rural debts or loans below or above a certain size. These occur from time to time in South Asian countries, where some candidates for parliament advocate or promise debt forgiveness.

In many countries foreclosure on tangible collateral is almost impossible, highly uncertain, or very costly. When the World Bank began its efforts in financial market reform in Bangladesh, it discovered that it took an average of 19 years for a commercial bank to obtain a judgment against a defaulter in the local courts: that is only a judgment, still leaving considerable distance between a bank and its money. It comes as no surprise that industrial credit in Bangladesh remained highly concentrated among insiders who were trusted, at least in a relative sense, and among those with political connections. In the recent past in the Philippines, a defaulter's land could not be repossessed by a lender until 1 year after notice was given. Not surprisingly, many defaulters' homes are found in poor condition at the time seizure occurs.

Security of tenure on agricultural land and clear title to other assets are also important determinants of debt capacity because they give the owner or operator incentives to invest and to perform efficiently. This permits realization of greater returns as well as the ability to pledge assets as loan security, contributing to debt capacity both ways. (Collateral in the form of valuable assets pledged to the lender is not an essential part of several approaches to microfinance, although it can facilitate access in many cases for those among the more prosperous strata of the poor.)

Although collective guarantees and group organization are measures that can increase the debt capacity of participants, group credit is not necessarily a panacea because confidence is not always present and may remain difficult to build. Some activities may be too complex for groups to undertake effectively.

Bureaucratic impediments, especially in business formation and operation, reduce debt capacity. In addition to problems with perfecting property rights, including financial claims, entrepreneurs may have to pay bribes and incur other, high transaction costs to obtain a trading license, a place where they can conduct business, or connection with state-owned electricity and phone lines. In some countries lending officers of state-owned banks expect a kickback for loans issued.

In short, many conditions of poverty and underdevelopment conspire to keep debt capacity low, excluding the bulk of the population from access to formal financial services. This makes the provision of loanable funds, as through donor projects or government largesse, no more than a partial response to the problem of access, and one that is frequently unsustainable, inefficient, and inequitable.

Summing Up

Creation of debt capacity should be the ultimate objective of every effort to increase access to credit. Activities with this goal should have a clear focus on precisely how access will be created: lengthening term structure, reducing transaction costs, or refining valuation processes within financial markets or through related improvements outside financial markets. Progress toward sustainability, consisting of specific targets and the necessary staffing and technical requirements for achieving them, should be built into every plan for increasing access. Sustainability requires lending institutions that cover their costs and produce sufficient surplus to enable them to grow. Sustainability means that borrowers and prospective borrowers can have continuous access to credit based on their performance and circumstances. Access will often be represented by unused debt capacity, which offers a wonderful platform for seizing opportunity and for managing risk.

Sustained development at the small end of the financial sector is most likely to occur when financial markets are competitive and transparent. Competitive markets naturally work to reduce costs and to increase services, each of which promotes access. Transparency fosters accountability by those active in financial markets and by those who intervene in them and regulate them. Transparency also requires that lessons from failures be studied carefully and that attempts at innovation be based on good information and create constructive incentives for all concerned.

When these conditions are at least partly met, financial markets will naturally expand their outreach, creating debt capacity through innovation and in response to confidence-creating improvements in other economic sectors and in society in general.

NGOs in Microfinance: Past, Present, and Future

Thomas W. Dichter

Outreach and sustainability have been the dual mantras of much of the applied literature on microfinance in the 1990s (see, for example, Bennett, Goldberg, and Von Pischke 1994; Christen et al. 1994; Gurgand, Pederson, and Yaron 1994; Otero and Rhyne 1994; Von Pischke 1995; and Yaron 1992). To be taken seriously among donors and microfinance leaders, a microfinance intermediary needs to achieve financial services outreach to the poor while maintaining its own financial sustainability. This paper, which deals only with NGOs in microfinance, looks at how NGOs have done with respect to these success criteria, at what microfinance NGOs have accomplished with respect to poverty reduction, and at what their prospects are in the future of microfinance.[1]

With a few notable exceptions, the record of NGO microfinance intermediaries on outreach and sustainability should give us pause—hardly any NGOs have reached financial sustainability and fewer still manage to do one without sacrificing the other. Moreover, the overall record of microfinance NGOs on the aggregate impact on poverty reduction (the point of donor-sponsored microfinance in the first place) offers even fewer reasons for enthusiasm. In retrospect it appears possible that the high expectations about the right fit between NGOs and microfinance may have been misplaced.

If the NGO record in microfinance thus far is less than what was hoped, why have NGOs come to dominate most of the dialogue on, if not the actual practice of, microfinance, and in so doing changed some of the rules of the game, perhaps to the long-term detriment of the very group they want to serve—the poor?

To get behind this paradox, a historical and contextual approach is necessary. Microfinance is first put in the context of recent development assistance history; then NGOs are put in the context of other players in microfinance; third, microfinance is looked at historically to see how its aims and targets have changed. Finally, the record of NGO achievement to date is examined in detail.

Historical Context: Cautionary Parallels

The 1990s could be labeled the microfinance decade. The proliferation of new microfinance projects since the beginning of the decade has been phenomenal (and led by NGOs), enough so to warrant caution. That caution is bolstered by some intriguing historical parallels with an earlier decade in development assistance, the 1970s.

The 1970s saw the rise and reign of two

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related themes: basic human needs and integrated rural development (BHN/IRD). These emphases arose as a reaction to the two prior decades of development, when the focus had been almost exclusively on economic growth. Many of those concerned about the poor had begun to deride growth as having very limited or too-slow trickle-down effects. Growth did little to reduce social inequities, much less deal with absolute poverty.

As poverty began to move to the center of the official development agenda, growth with equity became the objective. NGOs applauded the BHN/IRD movement in part because it put people squarely on the development map. Some scholars of development have indeed called the BHN/IRD movement a form of development populism (Lewis and Kallab 1986).

By the early 1980s, however, BHN/IRD approaches were less attractive, partly because the results were not what had been expected. Today we hear almost nothing about these approaches. In a way they collapsed under their own weight. BHN/IRD expected, and tried to do, too much, trying to solve technical, social, and economic problems all at once (Lewis and Kallab 1986). Their strong point was the populist thread—the commitment to the grassroots and to people. But in the end they did not give much priority "to aggregate agricultural output or to building the human and institutional infrastructure for development" (Lewis and Kallab 1986, 8).

The parallels with microfinance are not perfect, but they are close enough to justify caution about the rise of NGO involvement. Consider development assistance trends in the decade following the zenith of BHN/IRD. The 1980s was a time of crisis (the food crisis in Africa in the early 1980s, then the debt crisis), a time of public doubt and criticism of aid, and within many development assistance agencies, a time of disillusion, of lowered expectations, and even some introspection and self-criticism. A new paradigm for poverty reduction was awaited. The donors, criticized by many, including NGOs, needed something that was at once socially caring and appeared solid enough to promise poverty reduction. By the late 1980s microfinance provided these, along with a new conventional wisdom, just as BHN/IRD did in the 1970s.

By the mid-1990s, if the growth in the number of practitioners, donors, conferences, and publications devoted to the field is any indication, microfinance had emerged not only as mainstream, but as *the* field to get into.

Now, as the end of the 1990s approaches, because so many microfinance programs around the world have been under way for a number of years, we have for the first time a substantial body of data, and we see some limits to what microfinance has been able to accomplish. Microfinance is more problematic than we had thought, but more serious is the growing evidence that, like BHN/IRD in the 1970s, microfinance, *especially in the hands of NGOs*, has given too low a priority to aggregate output and to building the human and institutional infrastructure for sustained development. NGOs have focused microfinance largely on credit and on the immediacies of poverty, and they have tended to think (as was the case in the 1970s with BHN/

[1] This paper is based in large part on research conducted by the World Bank's Sustainable Banking with the Poor Project. The broad aim of the project, initiated in 1994, is to distill best practices and lessons learned by studying in depth a large number of microfinance programs operated by different kinds of organizations around the world. The paper does not address the role of credit unions or banks in microfinance, but concentrates on the NGO record.

IRD) that what they offer is what people need and can use effectively.

There are also some informative differences between the NGO dominance of microfinance in the 1990s and the NGO BHN/IRD movement in the 1970s. BHN/IRD fell apart partly because it tried to do almost everything at once. In contrast, microfinance set out in the 1990s stressing minimalism—credit only, or sometimes "credit-first"—thus shedding the complexities and ambiguities of marketing, of technical assistance, of enterprise formation and transformation. This minimalism—reducing enterprise development to credit—was another manifestation of populism. The people know best. They *are* naturally entrepreneurial, they do not have to be urged or taught to be. They know their business. What they need is credit.

Therefore microfinance practitioners since the beginning of this decade have concentrated on mastering a rather straightforward set of technical tools, largely adapted from banking. Context and local conditions, the eternal bugaboo of all development models, wonderfully this time, almost did not matter—the techniques, the vocabulary, and the arithmetic of credit delivery were universal. All of this made microcredit highly attractive.

And with the 1990s concerns about outreach and sustainability, in a sense, even the overarching goals of microfinance have been reduced to minimalism. Practically speaking only two things are now demanded of microfinance practitioners: to aim, with great deliberateness, for financial self-sustainability, and to do this without sacrificing outreach to the poor.

What progress have we seen? Relatively few microfinance programs of any kind have succeeded in achieving this very problematic balance, but the record of NGO-run programs is particularly disappointing. Comparisons with other kinds of institutions in microfinance illuminate the NGO record to date.

NGOs and Other Institutions in Microfinance

In 1995, the World Bank's Sustainable Banking with the Poor Project (SBP) began an ambitious survey. Until then no attempt had yet been made to gauge the dimensions of the microfinance movement, nor really to get many answers to the question of what exactly the record showed. The SBP estimated that in mid-1996 there were more than 1,000 microfinance institutions in over 100 countries, each reaching a minimum of 1,000 clients and with 3 years of experience (absent these restrictive criteria, the total number of microfinance projects/programs may well be 5,000 to 10,000). A short survey was sent out to as many of these as could be reached, and 206 responded. Of those, 73 percent were NGOs, 13.6 percent credit unions, 7.8 percent banks, and the rest savings banks (Paxton 1996).

The total outstanding loan balance reported by the survey respondents in September 1995 was US$7 billion, equaling about 14 million loans to individuals and groups. The total of deposits was US$19 billion, equaling about 46 million savings accounts.

Interestingly, banks account for 78 percent of the total number of outstanding micro-loans, and credit unions 11 percent. But NGOs account for only 9 percent, and savings banks (which are not primarily in the credit business) just 2 percent. Looking at the outstanding loan balance, NGOs fall further to the rear: banks accounted for 68 percent of the total outstanding loan balance, savings banks 15 percent, credit unions 13 percent, and NGOs 4 percent. Based on sheer numbers, banks and credit unions show significantly greater overall outreach than NGOs (Paxton 1996, 19). It is true that NGOs' outreach, *on average*, is deeper, but it is also narrow—they may reach some very poor people, but they do not reach many. And it is because credit unions and commercial banks also serve some wealthier clients that their average outreach to the poor is not as deep. Still, the indications are that overall, credit unions and commercial banks serve more underserved, poor clients than do NGOs.

In terms of outreach, NGOs stand out in one important respect. Female-based programs are primarily NGO-run (63% of the NGO microfinance programs in the sample were female-based).

Sixty-two percent of funding for female-based programs comes from donors (as opposed to 48% for male-based programs). Furthermore 63 percent of female-based program deposits are compulsory. Again not surprisingly, NGOs were the only type of microfinance institution that had fewer depositors than borrowers.

Sixty-nine percent of the surveyed institutions were created after 1980, the vast majority of which are NGOs. The high birthrate of NGO-run microfinance programs and projects continues.

NGOs are also more aggressive in expanding their loan portfolios, an indication of their newness, as well as a reflection of the pressure to go to scale. The 1993–94 median loan portfolio growth rate of NGOs averaged 49 percent, twice the rate of savings banks and credit unions.

As the report states, "The growth rate of the loan portfolio was found to be inversely related to the depositor-borrower ratio since programs lending from member savings are likely to be cautious in their expansion . . .rapid growth has been correlated with higher rates of arrears" (Paxton 1996, 22).

Perhaps the most remarkable finding emerging from the SBP inventory was the reminder that far more people are being served by savings services than with credit. Worldwide demand by the poor for safe, liquid, and interest-bearing savings instruments is enormous, and capacity to save is evident. But we hear little about this from NGOs.[2] As the inventory report states, "The median number of deposit accounts in NGOs is zero, as most programs are not allowed to collect deposits by law or prefer to use concessional donor funds for financing" (Paxton 1996, 27).

NGOs are by no means all the same. Not all who say they are involved in microfinance embrace minimalism. Indeed the SBP inventory showed that NGOs are more likely than the other three types of institutions to offer an array of social services in addition to financial services. The NGOs surveyed had an average of 1.3 social staff to 1 financial staff (in reality financial roles are often added to the roles performed by social staff). Nor do all NGOs in microfinance fully believe in financial sustainability or even in an eventual elimination of subsidies. Some may even actively resist microfinance best practices on the grounds that these may render them too businesslike and less responsive to the needs of the poorest.

But differences aside, there are undeniable general trends and expectations. The clear trend has been for NGOs to get on the microfinance bandwagon, and then move toward minimalism and balancing sustainability and outreach. And donor expectations—about what

[2] By far the largest gathering of microfinance practitioners took place in Washington, D.C., in February 1997 under the title "The Microcredit Summit." It is hard to find a better manifestation of the notion that savings is the forgotten half of microfinance.

microfinance can accomplish, about the natural fit between NGOs and microfinance, about the promise of poverty alleviation through microfinance—have fed the general trend.

NGOs and Microfinance History

How have NGOs taken center stage in many discussions of (and much donor agency planning for) microfinance, even though, as the SBP inventory has shown, they are neither the major nor the most exemplary practitioners? It is revealing to go back a short 10 or 15 years to see how the development vocabulary has changed and what those changes signify. In rough chronological order, the family of interventions from which today's microfinance emerged has expressed its changing emphases through the following lexicon:

Small and medium industry promotion
Small and medium enterprise promotion
Entrepreneurship training
Business development
Small enterprise development
Business training
Business advisory services
Small and medium enterprise credit
Microenterprise development
Credit for microenterprises
Microcredit
Minimalist credit (credit only, credit first)
Microfinance
Financial intermediation for/with the poor

The Core Notion of a "Business" and Interventions That Can Help It Develop

From the late 1970s to the late 1980s when major donors discussed small and medium enterprise promotion, the emphasis was on helping small businesses to grow and gain a greater share of the market. The assumption was that small-scale enterprises were important net generators of jobs and that the backward and forward linkages produced by a vibrant small and medium enterprise sector contributed to economic growth. Although there was some debate about what "small" and "medium" meant, no one questioned the fundamental notion of a business.

By and large a business was understood as an entity that had assets (e.g., equipment), plant (a location in which to operate), and employees. A central, if often implied, premise was that the entity was ongoing—it could be located at a particular place and visited again at that place later on. The mainstream actors in the small enterprise field generally agreed that the kind of help small businesses needed involved a mixture of the following: skills (business, production, marketing), appropriate tools and technology, access to materials and other inputs, access to information, innovations in production process and product differentiation, access to transportation, access to markets, and financing for fixed assets and working capital.

As for indirect help, it was also recognized that small business needed a significant degree of public-sector support, in the form of what briefly came to be called "an enabling environment," including appropriate policies, favorable regulations, and reliable infrastructure.

In addition, it was recognized by most mainstream professionals who studied small and medium enterprise promotion that still other factors influenced the prospects for small businesses. The political environment, for example, is critical; simple questions like whether the country is stable and whether corruption is widespread need to be asked.

In sum, the field of small and medium enterprise promotion was viewed very much in context. Most important, it was addressed in all its complexity.

Growing Awareness of the Special Needs of Microenterprises

By the late 1970s, considerable understanding had been gained about the special nature of enterprises run by low-income people in developing countries, and there was beginning to be a commonly agreed-upon set of interventions, exemplified by this list from the World Bank (Gordon 1978):

> Direct institutional procurement to SSEs . . . .
> Encourage subcontracting by large firms to small firms . . . .
> Develop industrial estates . . . .
> Broaden lending by conventional development finance companies.
> Provide working capital . . . .
> Devise alternative means of loan security . . . .
> Develop simpler lending criteria and procedures . . . .

(This list anticipates by some 20 years quite a few of the very things that the new world of microfinance is engaged upon.)

The term micro was not used at all by the mainstream until the late 1980s, though certainly there was discussion of the informal sector out of which "micro" emerged. Along with a concern for the direct alleviation of poverty, led by NGOs, came the discovery of an even smaller level of economic activity, the microenterprise. And a few NGOs began working, fairly quietly, in microcredit.

Despite this, in the early 1980s, NGOs were not generally considered likely candidates for credit delivery (see, for example, De Jong 1984).

Both the emergence of credit as a dominant enterprise-development theme and the interest in a credit role for NGOs, began to connect in the late 1980s. Not coincidentally, credit also emerged as microenterprises entered into mainstream (or more precisely, main donor) thinking. One could argue that it was the Committee of Donor Agencies for Small Enterprise Development that gave legitimacy to the joining of microenterprise development and credit minimalism, and in turn their marriage to NGOs. Its June 1988 meeting in Washington was a focal point for a large number of issues being debated. It was there that the term minimalist may have been coined. And it was there that NGOs were called upon as naturals to provide credit to the operators of most microenterprises—the very poor. NGOs could do it, it was assumed, because they were both ideologically motivated, and as grassroots practitioners, appropriately positioned.[3] Banks and governments, it was now claimed, could not be counted upon to reach the poor effectively (see Schmidt and Zeitinger 1996).

By 1988, to the extent credit was emerging as a singular intervention, the donors' committee meeting[4] hammered home the concept of a specialized, new kind of financial intermediary (Jackelen 1989).

The term microcredit (not to mention, microfinance intermediary) had not yet appeared as a banner on the horizon, but the die was cast.

Still, the perspective of the movement remained fairly broad in terms of interventions. As one of the donors' committee meeting reports noted, "It is generally recognized that financial assistance alone will often not be enough to help small enterprises establish themselves, over-

[3] The standard argument for NGOs as partners in any development program aimed at the poor has generally rested on four presumed characteristics: their closeness to the poor, their nonbureaucratic nature and thus ability to respond flexibly to changing conditions, their low cost, and their political independence.

[4] Levitsky 1989 contains the papers of the conference in Washington D.C., June 6–9, 1988, sponsored by the Committee of Donor Agencies for Small Enterprise Development.

come their problems and grow . . . ." (Levitsky 1989, 16).

In the course of a mere decade and a half, we now see that enterprise development has slipped almost unnoticed into obscurity. As have outputs, which, as this excerpt (El-Namaki 1984) illustrates, were a matter of course a decade ago:

> The ultimate output is, obviously, a contribution to the gross domestic product (GDP) SSEs . . . the success of the SSE finance system should be measured according to the impact in terms of development objectives. . . . Sustained employment and income generation, together with the development of indigenous entrepreneurial capacities are the final test of achievement.

The current microfinance debate has relegated these kinds of outputs to the periphery, to the extent they are talked about at all. Some of today's most successful NGO microfinance intermediaries, as measured by financial sustainability and outreach, give perfunctory treatment to the issue of employment creation, as if it were a bone to throw at a few recalcitrant skeptics (see Dichter 1997).

As NGOs became more involved in credit projects, the poverty focus of microfinance became more and more specific and direct. The twin tendencies of immediacy and populism brought women prominently into the NGO microfinance agenda, not only because they are better repayers than men, but because they use the benefits of credit to help their families. At the same time another term became widely used—poverty alleviation—meaning to lighten the burden of poverty.

Business and enterprise almost silently slipped out of the agenda as less and less sophisticated entities became the substitutes for viable enterprises. No longer always called businesses, the objects of lending were, at best, "economic activities" or "income-generating activities." Soon also, many loans began to go for consumption rather than for productive assets. This too was deemed to fit well with the immediate goal of alleviating poverty.

It should not be surprising that now relatively little is heard about enterprise development. As lending was pushed down the low-income scale, albeit never as far as the absolutely destitute (held in check by the sustainability goal), genuine enterprise lending had to be dropped by the wayside because the poorest people have less real absorptive capacity and less debt capacity for business lending.

Inadvertent as it may have been, the process of hermetically sealing off the world of microcredit from its larger economic context was under way. The late 1980s and early 1990s was also a time of humility on the part of the large players, especially the World Bank. Thus, embracing poverty alleviation and NGOs as instruments and partners became politically correct. Microcredit, as practiced by NGOs, especially the famous few who could show impressive numbers, was universally embraced.

Today, the focus is almost exclusively on the action (credit) and the financial health of the actor (the sustainability of the microfinance intermediary).

The point of microfinance best-practice studies has been to improve the operations of the lender. It seems to be assumed that there are no more controversies about the effects of microfinance. The key to recognition has become how well you lend and how many poor people you can reach; not what your lending does to influence growth, or create jobs, but what it does to alleviate the immediate effects of poverty.

What had started out in the late 1970s

as economic goals have been replaced by social goals: redistribution (via reliable and equitable access to microcredit), providing the safety net of consumption smoothing, enabling small improvements in family welfare by aiming credit at women, and women's empowerment. Meeting these social goals, which indeed appear to be met by microcredit, seems to come at the expense of the economic goals, however. At the heart of the matter therefore is an old question: is the goal to relieve symptoms or to cure the disease?

Market for Microfinance

We said earlier that NGOs have tended to believe, quite naturally, that what they offer is what is needed. It has been assumed that the poor need and want credit and that they will use it to invest in their economic activities, thus earning more money and eventually crossing the poverty line.

The SBP case studies (20 of the 35 were NGO-run microfinance projects or programs) did not systematically attempt to measure demand for financial intermediation (the focus was, as it has been in the industry generally, on outreach and sustainability), but in most of them the field researchers did interact with a large number of clients and reported both on demand and loan use.

Loan Use

The studies reaffirm the notion that money is fungible. The more the case researchers probed loan use, the larger the variety of uses they found (including using a loan provided by one NGO to pay off a loan provided by another NGO). By far the greatest real need among poor women borrowers were loans used to "help raise the family." In more technical terms what such borrowers are doing is ironing out the ups and downs of fluctuating income so that necessary consumption can be maintained. The term consumption smoothing has come into use to describe such loan uses. If we were to rank loan uses in order of actual frequency of use, regardless of *intended* purpose, consumption and housing would rank first, working capital (cash flow) for activities in commerce, trade, small manufacturing, service activities and agriculture (e.g., purchase of an animal) would rank second, and loan use for the development of an ongoing enterprise would rank third.

It is of course arguable that loans for consumption, medicine, or school fees are in a sense investments in the person and the family as productive assets themselves. But such an argument skirts the issue of the kind of increased output that was originally expected from microlending—output premised on business-related investments. In any case, in general the expectation that credit will lead to productive asset use and thus increased output has not been met (see, for example, Mahajan 1996, 2).

Demand

Since the shift to minimalist credit was premised on the conviction that credit was a critical missing link in the economic lives of the poor, it is crucial that their demand for credit be examined. First, the fact that poor people *say* they need credit does not equal what economists call effective demand. One has to look at their capacity for debt (how much debt can they bear without getting into trouble) and their capacity for credit service (on what terms and by what means can they pay down or pay off their debt). NGOs tend to emphasize people's stated need for credit, but to the extent they forget that credit is also debt, and then ask questions about debt capacity, they miss an important part of the demand picture.

Moreover, the poor themselves are very aware that credit, until repaid, is debt. Many poor people borrow only because they have an immediate need for cash that they cannot see any other way to satisfy, not because they feel they can make productive use of credit. Although the proliferation of microcredit programs reaches a great many borrowers, there is a larger number who are reachable but do not want to become borrowers.

For many microenterprises, the economic activity is first of all a means of survival. When developing economies come upon hard times, microenterprises come into being at even faster rates and their products become in greater demand: "The demand for products and services provided by microenterprises for the local or domestic market rises with overall shrinking incomes" (Fidler and Malhotra 1996, 6). These products are, of necessity, low quality, low priced, and low profit. Many if not most microenterprises are hedges against disaster, ways to get some ready cash.

The literature on informal-sector microenterprise characteristics shows that most microenterprises:

- are generally one person
- were started using their own savings
- find easy entry into the marketplace
- are low skill
- experience low or no growth *even with* financial services
- have high death rates (go out of business)
- have low productivity
- operate out of home or are mobile
- sell whatever they make or serve directly to the consumer
- operate in a market with very high levels of competition (for women this competition is even fiercer)
- that operate in "manufacturing" are in fact engaged in making and repairing things of low quality and low value
- that operate in trade are involved in low margin street vending, and food services.

The difference between microenterprises and larger firms is not just size but quality. Microenterprises are not tiny versions of sustainable growing businesses. Few are dynamic firms. Although in strict accounting terms, some microenterprises can have high rates of return, this is not to say that they can move their operations forward economically. In the majority of developing countries only a minority of informal firms with four workers or less experience growth of any sort. Indeed informal-sector growth comes not from firm growth but from net gains in firm births.

Although most surveys report lack of access to financial services as a high-priority constraint for microenterprises, in quite a few surveys the top self-reported constraint is not financing but what is often vaguely called marketing—constraints like saturation, competition, inability to differentiate one's product from those sold by competitors, and lack of information about quality. In fact, many microenterprises will be less viable when, and perhaps especially when, the surrounding market conditions begin to be economically well articulated, dynamic, and competitive on the bases of skill and quality.

Somewhere along the way in the last dozen years, NGOs played a role, wittingly or not, in the subtle divorce between enterprise development and microcredit. To the extent that the NGOs in microfinance seek to aim credit at the poorest operators in the informal sector, they tend to engage in poverty lending and not in enterprise development.

Because of the kinds of biases that have become part of present-day NGO microfinance, especially the widely accepted need to go to scale (outreach) and be self-sustainable, an entire layer of enterprises is left out of most microfinance programs. An example of this "missing middle" is an urban metal workshop in East Africa, with eight full-time employees and several old but working machines. The owner is capable of small manufacturing, but operating in a small poorly organized space, with inefficient machines. Production of a block machine (based on prototypes that have been tested) which he believes has a ready market cannot be financed. Rent has gone up by a factor of four in the last 3 years. Taxes are also going up. Whereas this entrepreneur was on his way up (tenuously) 2 years ago, he is now on his way down. He believes that 2- to 3-year term financing would enable him to produce and sell the block making machines he has designed. He cannot get long-term fixed-asset financing.

The marketplace for microfinance has become wrongly skewed. Many who could make productive use of accessible and flexible loan products cannot get them. And many of those who cannot make productive use of credit are targeted for micro-lending, and in some markets have a choice of lenders, as more NGOs enter the field.

A better way to characterize the real needs of many poor borrowers is to talk about risk management or income protection instead of credit. To paraphrase Stuart Rutherford (1996), the poor by definition do not have much money, so their need to manage what money they have is great. This is why they use many of their loans for consumption smoothing, i.e., yet another way to manage risk, to protect and stretch income.

Savings, of course, is the ultimate risk management tool. The SBP case studies have repeatedly shown that the demand for savings opportunities is greater than for any other financial service. This has shown up in several ways, including the discovery that many female members of such group lending schemes as village banks (e.g., CARD/Philippines, CARE/Guatemala) do not take loans at all, or take one loan and then become inactive borrowers, but stay in the group only to continue to save.

CGAP (the Consultative Group to Assist the Poorest), part of whose mandate is to help microfinance intermediaries improve performance, has concluded: "most microfinance clients want to save all the time, while most want to borrow only some of the time" (*Focus Notes* April 1997).

What does this high demand for savings products tell us? As Rutherford (1996) has said, "it would be unwise to look to financial services as a . . . sufficient means to [impact levels of poverty, or women's empowerment or local employment]. This is especially true of NGOs who are tempted to work with only the credit element of financial services" (Rutherford 1996).

The problem for NGOs in dealing with savings is of course that from a risk-bearing standpoint, savings mobilization and microcredit are not the same, which is why the law treats them differently. From the clients' point of view, the risks of saving with an NGO are masked by their growing confidence as NGOs show that they are here to stay. But most NGOs are not operating in regulatory environments that permit them to mobilize deposits; they do not benefit from deposit insurance nor are their operations controlled by bank supervision agencies. And when covariant risk is high as it is when group members are all from the same sector and necessarily from the same community or locality, the tenuousness of the NGO position is even more dangerous to the saver.

Savings mobilization—probably a more valuable route than microcredit to self-reliance and true poverty alleviation—may simply not be for NGOs. But this is somewhat a moot point. Few NGOs have thus far talked much about savings. Since credit is what they offer, this, they assume, is what is in demand.

Yet if microfinance institutions in general (not just NGOs) are to be responsive to the poor as a special market for financial services, savings must move into a prominent position. It is somewhat of a mystery why savings have been so underemphasized both in conferences and in the literature. A partial explanation may be that savings mobilization programs would not absorb large amounts of donor money. The irony of course is that donors are major promoters of sustainability, which is another way of saying financial independence. Assisting the poor in protecting and expanding their savings is not only a clear route to financial independence on the part of the microfinance intermediary, it is a clear route to financial independence for the poor themselves, and thus highly developmental.[5] NGOs, by emphasizing credit in part because they are precluded from emphasizing savings, may not be serving the poor with as much transparency as we ought to expect.

Typology of NGOs in Microfinance

Differentiating among NGOs in microfinance helps to put the relative newness of the field in perspective, highlights the small number of organizations that appear to be on a successful trajectory in microfinance, and suggests that there is currently a bandwagon effect that should cause concern. An appropriate typology of NGOs involved in or thinking about being involved in microcredit would consist of five types:

1. *Single-method microcredit replication networks*—NGOs that are linked to, or part of, an international NGO family or network that focuses on microfinance using a particular methodology. These networks actively promote microfinance expansion. Examples would be ACCION, Pride Africa, FINCA International, the Opportunity International network (which includes Zambuko Trust in Zimbabwe, TSPI in the Philippines, UGAFODE in Uganda), and the family of Grameen Bank replicators.
2. *Multipurpose international NGOs* that also have microfinance and microcredit components. Examples would be Catholic Relief Services, Plan International, World Vision, World Learning, Save the Children, CARE, and Actionaid.
3. *Multipurpose national NGOs* that also have microfinance components and that are not part of any formal family, though they may have informal linkages. Examples are CARD (Philippines), AKRSP (Pakistan), Myrada (India), and SEWA (India).
4. *Microfinance-dedicated national NGOs* that either came into being solely as microfinance organizations spun off from international NGOs or that were helped to become significantly invested in microfinance through international donor support. Examples are Alexandria Business Association (Egypt), K-Rep (Kenya), Pradan (India), and PPCCR (Burkina Faso).
5. *National, localized, and sometimes community-based (membership) NGOs*, generally very small, with few if any linkages to other organizations.

There are tens of thousands of these registered, and their number is growing. Many are entering the microfinance field. Some have been characterized as briefcase NGOs, which have come into existence in the hopes of capturing funds.

This typology is both hierarchical and pyramidal. At the top are the well-known NGO microfinance intermediaries. Programs like ADEMI, Grameen Bank, Prodem/Bancosol have become models for others. But there are relatively few of them. At the bottom are those in type 5. They are beginning to practice a form of microfinance, but little is known about how they do it.

The first of the five categories represents a strong network of technical capacity and growing learning related to best practices.

The second group is behind in terms of best practices but seems to be very aware of them because these NGOs are in communication with the rest of the microfinance world. The fact that they are part of organizations with other purposes (like relief) complicates their microfinance work.

The third group is expanding and being encouraged by donors. A major potential problem with this group of NGOs is the likelihood that they will lend to the poor at highly subsidized rates. Often they are able to do this because they are using money channeled through them from donors who are themselves NGOs. The Zimbabwe Women's Bureau, a small local NGO that is funded by a large international donor (Oxfam), lends at interest rates of 5 to 10 percent, when in the same marketplace, Zambuko Trust (which is having its own financial problems) lends at the maximum rate allowed by law—32 percent (Fidler and Malhotra 1996, 43).

The fourth group (national NGOs dedicated to or significantly involved in microfinance) is also being taken seriously by donors and is often encouraged by them to consider bank formation.

The fifth NGO group is the weakest by far. It may well be ephemeral and an investment in research would be needed to understand its characteristics more precisely. These are local NGOs, often community groups, that are generally unclear about what microfinance is. Given their lack of capacity and understanding, they are likely to do as much harm as good.

Have NGOs Become Effective Microfinance Intermediaries?

Outreach and Sustainability

The demands of 1990s style microfinance are relatively narrow. Measurement, and hence success, is confined to the twin axes of institutional sustainability and outreach to the poor (access to credit by the poor). At best, for NGOs, achieving a balance between sustainability and outreach has been continuously problematic; at worst, it appears to be not really possible. The empirical record shows that as more and more NGOs in microfinance, often encouraged by donors, come to accept the two goals of sustainability (subject to tough measurements like the World Bank's subsidy dependence index) and outreach (measured increasingly by loan size relative to GNP per capita), they tend to make several trade-offs and adjustments:

- concentrating portfolio growth in areas with high population density, thus focusing less on rural areas

[3] Savings, moreover, benefits the savers developmentally because the monies saved are the savers' own money ("hot" or "warm" money, as opposed to donor money which is "cold" money, and about which the borrower cares less. One difference between the two is the greater moral hazard involved with cold money).

- emphasizing rapid initial loan volume growth, leading to poor portfolio quality
- keeping field staff salaries low (or alternatively raising the number of clients per loan officer) to control costs, thus tending toward high turnover and low morale
- moving toward the retail trade and service sectors for high cash flow to achieve high repayment rates, thus tending away from manufacturing and fixed-asset lending
- emphasizing short-term loans as a strategy for high repayment and loan-size growth, thus eliminating cyclical sectors like agriculture
- moving up the poverty scale away from the very poorest to maintain loan demand and repayment rates

With trade-offs like these, a sustainability trajectory is certainly achievable in the short term. And operational break-even—a step toward full sustainability—*is* achievable in as little as 18 to 24 months of branch or even program start-up. There are, however, hardly any NGO microfinance intermediaries that have achieved full sustainability so far.

Most NGO microfinance intermediaries genuinely attempt to maintain outreach to the poor. But even for those able to do so, there is some evidence that they are not reaching people who have never before had reasonable access to credit.[6] In only one-fourth of the SBP NGO cases can it be said that the clients of the NGO microfinance intermediaries had no other real institutional options for credit. And in a third of the SBP NGO cases, there was competition from other NGOs offering credit in the same market. Also there is upward creep away from the poorest of the poor in the interests of high repayment and ultimately of sustainability. Such shifts in target were documented in 75 percent of the SBP NGO cases. A full three-fourths of the SBP NGOs operated in urban or peri-urban areas and in cases (like CARE/Guatemala) where coverage had begun in rural areas, some drift toward urban targets has been observed.

In fact, when SBP compared 11 microfinance programs from around the world that had good records on outreach (as measured by average loan size as a percentage of GNP per capita), the Indonesian bank programs BKD and LPD had far greater outreach than the next best NGO (Fidler and Malhotra 1996, 85).

Finally, outreach in terms of sheer numbers (as opposed to levels of poverty) is itself problematic. Programs that are considered veteran successes often took years to scale up and still do not reach large numbers. ADEMI, in its fifteenth year, has an active client portfolio of 16,000 in an estimated microenterprise population of 330,000 (Benjamin and Ledgerwood 1997).

Clearly, balancing sustainability with outreach is problematic, and may be more so for NGOs than for other types of institutions.

Repayment Rates

As an indicator of their success, NGOs newly involved in microfinance tend to point first to high repayment rates. Indeed, countless examples of real repayment rates over 97 percent prove beyond doubt that the poor can repay debts on time and with high interest.

But repayment rates have been, in a sense, a false comfort for microfinance NGOs. They have been taken internally as a proxy, not only for institutional performance, but for impact (under the willingness-to-pay theory: if the poor are repaying their loans they must be doing all right financially). The record, when examined in detail, suggests that in addition to the best-practice explanations for good repayment rates (high-frequency collections, tight controls, a good management information system, loan officer incentives, good follow up, and a quick jump on delinquency) and, on the borrowers' side, the effects of peer pressure in group-based schemes, and the attractiveness of products with relatively low transaction costs), other things are going on.

Again, the fungibility of money is important: many poor women repay by borrowing within the family as they did before the microfinance NGO came along. Some borrow even from moneylenders to repay NGOs. Second, contrary to what is often assumed, the number of credit options is growing in many of the areas in which microfinance NGOs now operate, and so it the opportunity to borrow from one to pay the other. Third, despite high effective interest rates, which the best NGO microfinance intermediaries, to their credit, have accepted as doctrine, these rates are not necessarily perceived as high by the borrowers. They often have had prior borrowing experience (even when they say they have not), and because of initial small loan sizes, find repayment relatively easy, especially if they are in a high cash-flow position in the informal sector. Finally, as expected in best-practice doctrine, some borrowers keep up good repayment on initial loans because they hope for eventual access to much larger loans. But, as programs age, this very element of success (loan size growth) has begun to become a problem as debt capacity limits are reached.

Particularly in group-based programs, a domino effect (one group member defaults and the rest follow) is something practitioners have begun to worry about. One-third of the SBP NGO cases had experienced this effect.

It is also quite possible that high repayment masks other things, client drop-out rates for one, as well as accounting anomalies. Sixty percent of the SBP NGO cases experienced high client drop-out rates after the first few loan cycles, and a few long-established programs have low client retention rates.[7] In these cases repayment rates can remain high, even though loan demand is evidently questionable, because these NGOs adjust by actively seeking new clients. In 40 percent of the SBP NGO cases, the researchers found distortions or inaccuracies in how repayment rates were calculated. In 55 percent of the SBP NGO cases, the researcher judged the management information systems (MIS) to have serious flaws. Some reported rates are simply creative accounting artifacts. Other reported high rates may be because group funds (default insurance) have been used to erase the arrears from widespread default (Paxton 1997).

High repayment rates are not to be disparaged. After all, NGO microfinance intermediaries using best-practice have outshone major commercial banks in this regard. The point is rather that NGOs should not take too much comfort from these rates. They are not full measures of financial performance, and can be especially deceiving if the costs of achieving high repayment are also high. Finally, high repayment rates should not be seen as good proxies for impact.

Economic Impacts on Poverty

As already suggested, NGOs have driven microfinance further away from the economic impacts that would result from enterprise development. The record

[6] Only half the SBP NGO cases could be said to operate in areas with low bank branch density, for example.

[7] ADEMI in the Dominican Republic after 15 years has a 40% retention rate, compared with under 25% for Bolivia's Bancosol.

is increasingly showing that the impacts NGOs have had through credit programs aimed at the poor are limited to alleviating the immediate effects of poverty—consumption smoothing, cash-flow smoothing, and to some extent gains in women's empowerment. Indeed, we owe this relatively new understanding of the real but limited effects of microcredit to the considerable energy expended by some donors and academicians to elucidate the dynamics of household economics and develop client case studies.[8] But the original hoped-for economic impacts of microfinance—like widespread productive asset creation—have not worked out as planned. NGOs in fact say little about these kinds of impact.

The NGOs represented in the SBP cases were not systematically measuring impact in meaningful ways. But this is not surprising since current doctrine emphasizes outreach to the poor over everything else, and de-emphasizes impact measurement. As Otero and Rhyne (1994) have put it, at the heart of the new world of microenterprise finance is a shift in focus to the institution providing services—a financial systems approach. "In shifting focus, the financial systems approach necessarily relaxes its attention to 'impact' in terms of measurable enterprise growth and focuses instead on measures of increased access to financial services" (Otero and Rhyne 1994, 12).

Measuring economic impacts rigorously is hard enough. Attributing such impacts to microcredit is harder still. These difficulties certainly play a role in pushing economic impacts to the side. But to bracket impact in this way is to forget that microfinance institutions are not simply traditional banks. Banks are beholden to their stockholders and are not in business to make a dent in poverty. But microfinance is not a product for the financial marketplace just like any other. Microfinance was originally intended, and still is, as a tool for poverty reduction, and NGO microfinance intermediaries, despite their different emphases, do share a single larger purpose: they are in business to have an impact on poverty. So we must find out in the end whether access to microfinancial services results in changes in poverty.

In the SBP NGO cases, the impact evidence that was gathered by the case researchers showed consumption-smoothing effects along with signs of a redistribution of wealth (and influence) *within the household* as the most common impact (75% of the SBP NGO cases). And these impacts are consistent with the mission of poverty alleviation, which was explicit in the mission statements of almost all the SBP NGO cases.[9] There was no evidence of any increase in community-level accumulation of wealth, however. In less than one-third of the SBP NGO cases were there indications of returns to business enterprises as the result of the loans.

The data we do have on impact reminds us of the complex causes of poverty. It is not likely to be seriously changed by credit alone. "Chronic poverty does not appear to be due mainly to 'market failure' in credit or other markets, but rather to low factor productivity, and low endowments-per-person of nonlabor factors. If these conditions prevail, even perfect markets may leave substantial chronic poverty" (Pederson 1997).

The NGO Record Summed Up

Taken together, the record of NGOs in microfinance so far is generally well below expectations. This is so even for the relatively few NGOs that have long experience and are models for others. We see, moreover, that scores, and perhaps hundreds, of NGOs in microfinance are not using best practices or are struggling with them. There is so far little evidence of impact on enterprise growth, though certainly more longitudinal research is needed. On poverty reduction (increases in net wealth accumulation at the community level), there is also little evidence. But there is evidence of an easing of poverty's effects through consumption smoothing and of real changes within households as indicated by women's empowerment and a redirection of income toward family welfare. Yet even these latter changes have tended to make the tough balance between sustainability and outreach more difficult. In the end, however, we come back to what today's microfinance scorecard values most—the two axes of sustainability and outreach (access). What we see are a number of trade-offs that amount to Hobson's choices:

First, sustainability is possible with a high-technology MIS, positive real interest rates, and cost-conscious management that focuses on high repayment and volume growth. But it may be at the expense of taking on higher risk, poorer clients.

Second, a microfinance program can be on a sustainability trajectory by maintaining a shoestring budget. But by keeping such an eye on low costs that longer term results are starved to death (inadequate MIS, management, and follow up; trends toward lowering repayments and growing arrears), the institution falls back into subsidy dependence.

Third, when microcredit is really needed, and there is high outreach to the poor, it is all the more difficult to be sustainable, even when focusing on high-density areas and on high cash-flow sectors where high repayment will be likely. Client drop-out and flat portfolio growth without geographic expansion are signs that capacity ceilings are reached quickly in the sectors most sought after for high repayments. In the microcredit world, loan volume covers costs, and where capacity ceilings are low, high volume growth can only go on for so long.

Fourth, the further down the poverty scale microcredit (especially short term) is provided, the less likely enterprise growth and transformation will occur. Likewise, the greater the potential for enterprise growth and transformation, the less the borrower can make efficient use of small amounts of credit (especially short-term credit).

Fifth, in the early stages of a program, a financial intermediary can lend on a widespread basis and appear to be on a sustainability trajectory. The greater the demand for microcredit, the more we see borrower activities at the least sophisticated, most primitive levels of the economy. In such cases it is least likely that credit will be used for increases in productivity or business transformation, and the more likely that it will be used for other purposes. Also, because the poorest clients are resourceful, they do find other means of repaying, up to a point, and therefore their inability to use credit productively will be masked from those whose main interest is in sustainability and access.

Finally, the more we see microcredit operations focused at higher, more sophisticated levels of the economy among more genuine enterprises, the less useful is microcredit to the borrower. Often he or she continues to borrow in the hope of getting something else.

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[8] Todd 1996 is an excellent example of serious qualitative field work that has revealed different than expected impacts.

[9] An interesting exception is ADEMI in the Dominican Republic, which explicitly separates itself from poverty alleviation programs. Accordingly, its average loan size is three times the poverty line, and less than half of its clients are women.

Operational and Organizational Problems of NGOs in Microfinance

Half the SBP cases exhibited initial high portfolio growth and fairly rapid expansion, straining organizational capacity. These NGOs then encountered problems, including rising arrears and staff turnover. Half also experienced rising costs, which led to compromises. Another half experienced slower-than-expected growth, which also caused them to show a lower trajectory toward cost coverage. In 40 percent of the cases, the entry into microfinance was encouraged by donors. In a fourth of the cases, there were indications that what was driving the organization were the ambitions of a charismatic leader to be seen as successful in terms of sustainability and outreach. In half the cases, microfinance (almost always microcredit) was added to the organization's portfolio as a new component, in part, it seemed, because the headquarters of the organization needed to be seen as keeping up with development trends.

Drop-outs

Rising drop-out rates are increasingly evident in many programs that target the poorest borrowers. There appear to be three main reasons for dropping out. First, dropping out is related to poverty itself. There is evidence that drop-out rates increase as credit ceilings are raised (as clients get past the first loan cycles). Significantly many clients want greater amounts of credit but are not always in a position to carry the additional debt, largely because of limited absorptive capacity. Second, there are socio-cultural externalities that are also part of the poverty environment. Often clients drop out because there are cultural pressures on them (and especially on women) or because of migration or family problems. But the third reason is a function of microfinance itself, and it increases as the number of microfinance intermediaries in an area grows: clients sometimes drop out because they go to other microfinance programs that appear to give them a better deal (see, for example, Association for Social Advancement 1996).

Rising Costs

Whether encouraged directly by donors or by their own ambitions to expand, many NGO microfinance intermediaries encounter problems when they expand rapidly. Some show rising arrears and high portfolio-at-risk ratios, and they often have problems with their accounting and MIS systems. More often they develop operating inefficiencies related to rising administrative and personnel costs. For example, in FY 1995, 62 cents out of every dollar lent by Zambuko Trust went to paying employee salaries.[10] Vehicle costs, fuel, and repairs were three times the amount budgeted and were 34 percent of all administrative expenses in FY 1995, up significantly from FY 1994 and FY 1993. Staff training accounted for 30 percent of administrative expenses.

Staffing Challenges

Many microfinance NGOs show considerable weakness at the credit officer level. These weaknesses are often a function of their organizational culture, as well as externalities like the nature of the job market. Some challenges worth highlighting:

- Many NGOs that have moved gradually into microfinance based on best-practices try to take staff who are accustomed to disbursing food or grants and make them into people who are supposed to monitor loans.

- Management often sees a high ratio of clients to loan officers as a clear-cut way to keep costs down. But in a growth phase, this trade-off is dangerous—low morale, beginnings of turnover, MIS backlogs, and declines in portfolio quality can result.
- Recruitment of new staff is often done with cost in mind, and thus less qualified people are hired because they are cheaper. In a number of programs, staff do not fully understand the goals of the program.
- Well-trained staff will be poached as newer NGO microfinance intermediaries come into the same market.

MIS and Accounting Challenges

Many NGOs in microfinance have rudimentary MIS and reporting systems. They have not yet learned the value of reliable management information, and if they have in principle, they still need to learn exactly what information is worth getting and how to get it in timely fashion. On the accounting side, cost accounting is a widespread weakness, especially for NGOs with history of multipurpose development work that have now entered the microfinance field. These NGOs tend to track expenses but not costs—a holdover from the culture of grants common to many if not most NGOs.

But even among those NGO microfinance intermediaries with experience and professional capacity, there are accounting and MIS peculiarities that make it hard for researchers to make objective cross-program comparisons. "The devil is in the details" is a useful reminder for whose who seek to understand the true picture. Simple things like comparing effective interest rates become a problem when NGOs use different ways to calculate them. Although these different formulas may be legitimate, full transparency would require giving the formula used along with the results obtained.

And because NGO microfinance intermediaries are neither banks nor for-profit companies, the choice of what data to report and how to report them is theirs to make. Terms that are standard in banking, like liquidity, owner's equity, and retained earnings, are used by NGO microfinance intermediaries without necessarily meaning the same thing. And impressive compilations of data comparing microfinance programs are often based on self-reported data, with no insights offered on how the various ratios were calculated.

Legal Challenges

When NGOs were engaged in nonfinancial work, the question of their legality and accountability rarely came up, but in microfinance it is beginning to. In other than membership NGOs (true grassroots organizations), the question of ownership becomes important once money becomes the commodity the NGO is trading in. In credit and especially in savings transactions, ownership is tied to the question of responsibility and ultimately of liability. Few NGOs microfinance intermediaries have begun thinking about these questions.

Graduation Dilemmas

Many approaches to best-practice microfinance in NGOs include the expectation that eventually clients will graduate to formal financial institutions. In the so-called village bank methodology, the

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[10] Among the established high performance microfinance intermediaries (Grameen, ADEMI, K-Rep, Actuar, BRI, etc.) the Indonesian banks have the best record in terms of staff efficiencies. Only a few NGOs come close. When salaries are measured as a percentage of outstanding portfolio, the average for these high-performing microfinance intermediaries (including some NGOs) is around 11%. See Fidler and Malhotra 1996.

expectation was that village banks would eventually graduate to independent status and would no longer need the external account relationship with the initiating NGO. But experience since the beginning of the 1990s has revealed some dilemmas in this regard. By encouraging the graduation of village banks that are ready, the initiating NGO often realizes that it is about to lose its best performers and those that are least costly to maintain, which in turn will affect the NGO's record as a microfinance intermediary. As for the village bank itself, it does not want to lose the sense of protection it gains from being affiliated with the mother NGO, and many formal banks, it turns out, do not want to bring these village banks under their wing.

Group-based Lending Challenges

There has been a slight tendency among NGOs to see group-based lending as an end in itself, rather than a means to an end. That tendency lies in the beliefs that the group form of lending is preferable for poor people, especially women, because it functions as a social intermediation mechanism and that poor people themselves prefer group-based forms of lending. Although there is little doubt that group forms have nonfinancial benefits that may be of great developmental importance, the SBP NGO cases show that when it comes to borrowing money, most people in the world (rich or poor) prefer and want individual loans.

It is useful to recall that group forms of lending (solidarity groups, village banking) originated mainly for the benefit of the lender as solutions to two problems faced by microcredit organizations: lack of collateral and the high transaction costs involved in loan appraisal, monitoring, and enforcement.

Now the challenge in group-based programs has to do with the other side to solidarity—solidarity can work both on the way down as well as on the way up. This is why instances of the domino effect where one member defaults and the others follow are becoming more common. And ironically, when groups are most solid in the sense that the members really come from the same small locale and share the same kinds of economic activities, co-variant risk, often leading to group default, is greater. More important still is the insight from one Bangladesh study that group default can itself be a function of group success (Yaqub 1995).

Learning

Few if any microfinance intermediaries are able to operate in total isolation. In almost every country, there is at least one committee of practitioners or one microfinance association. One would expect that NGOs lucky enough to be part of a network or an international NGO could start a new program in a country and benefit from the lessons learned elsewhere. But the evidence from the SBP studies suggests that the degree to which best practices and lessons learned can be transferred and applied with ease seems to be very limited. Each program appears to need to learn many of the same painful lessons from scratch. Yet this is not the case with commercial banks. (Why this is so with NGOs is discussed later.)

The Mission of the NGO Microfinance Intermediaries

The mission of an NGO plays an important role in determining what it does in the field of microfinance and how it performs. The variety of NGOs in the world means a variety of missions. By no means all NGOs in microfinance give prominence in their mission to outreach and sustainability. Some NGOs feel they must present themselves as committed to financial sustainability but have internal doubts and do not in fact take it as the most serious part of their mission. And there are NGOs that do microfinance and care little about sustainability. NGOs are by definition private organizations. To the extent they can afford it, they are free to pursue almost any mission.

There are a number of NGOs in microfinance that are small, led by committed people, staffed by young idealists, and limited in their scope and their ambition (CARD in the Philippines is one). At the same time they are not so limited in ambition that they are uninterested in expansion and immune to the impulse to seek recognition. They often do want to expand and are seeking a modicum of recognition, and of course both these ambitions are fueled by their being increasingly in contact with others and more aware of new ideas and standards of performance for NGOs of all stripes. They often take on a microfinance role and seek to achieve sustainability. But, at the same time, they do not want to give up their original mission, which often involves other activities among the very poor. They do not give much thought to impact beyond what they can see on an everyday basis—such as women having some small amount of extra income. Microfinance is yet another tool that they have learned to apply. It seems likely, however, that if pushed hard to achieve true sustainability (from a strict SDI point of view), many of these organizations would opt to continue doing things in the way they have been, even if that meant giving up sustainability.

The lesson to be learned from such organizations is the reminder that their way of being involved in micro-lending is a viable option for those NGOs that feel relatively sure of their work, and can afford to continue to do it with subsidies.

Things Microfinance NGOs Tend to Forget

This paper began by making reference to the evolution of microfinance and the NGO role in it. The NGO embrace of the hope and promise of microfinance as a significant breakthrough in poverty reduction suggests a gap between empirical reality and the record of performance to date. It also suggests that NGOs that have been around for some time have forgotten some of what they used to know.

Complexity

NGOs with real grassroots experience used to know that no one thing in development works all by itself. To the extent that efforts to promote planned business development are showing increases in long-term aggregate outputs, these are first related to physical and institutional infrastructure. Markets and roads are crucial. So is innovation. Businesses need to develop skills and competitive advantage. These things mean interventions such as training and institution building, pooling resources within a subsector to develop new products or new product designs or new techniques for production that maximize local resources, policy level work to deal with legislation affecting a subsector, and providing for the means of information flow about trends in other markets.

Context

"It depends" is a key notion in development thinking and NGOs with direct experience at the grassroots know this. Most challenges in development are often contextual—the political and regulatory environment, the nature of markets, etc. Many NGOs in microfinance have tended to enter microfinance, seduced in part by its technicity, without a careful look at or analysis of contextual factors, particularly the economic context. Where the economic and economic institutional context is good, NGOs will be more effective in their lending operations, but at the same time, they may well be less needed. Where the environment is poor, they will be more needed, but less likely to be financially problem-free.

Nonofficial Development

Experienced NGOs also know that developmental change can take place without official development assistance. In many countries where microfinance is widely practiced, there is evidence of the importance of remittance income as a source for people starting businesses and as a source of working capital. We have noted that people who want to build a business continue to find ways to do so. But major microfinance NGOs in their concern for legitimacy tend to ignore the potential of financial sources external to the microfinance industry.[11]

Time

Most important, many NGOs have forgotten that development takes time. Unlike the development and marketing of a new car model, which can be planned along a strict time line, a microfinance effort, even if the focus is single-mindedly on outreach and sustainability, cannot be easily kept to a time line.

Are NGOs Being Seduced by Commercial Values?

NGOs have moved from the fringes of the development assistance world to its center. They must now meet all kinds of new expectations rather publicly. The days of being hard-working voluntary organizations, burrowing away at local problems, and (almost thankfully) ignored by the larger actors in the development industry, seem to be over. As if this was not hard enough, NGOs today exist, like other organizations, in a world of development assistance characterized by the shrinking flow of official resources and the rise of private capital flows to developing countries. Yet, at the same time, the number of NGOs continues to grow, a response to the world's belief that they can make a critical difference. The resulting competition for funding and recognition adds significantly to their dilemma.

Most NGOs recognize that in today's climate doing good is not enough, especially in microfinance. They must be seen as tough, accountable, businesslike, and professional. To be taken seriously by most donors, they must strive to meet the twin test of sustainability and outreach, which as we have seen, almost always means wrenching changes in the way they work. In microfinance, many (though by no means all) not only want to be seen this way, they embrace these new values. Is it possible that many NGOs in microfinance are, in some sense, being tempted away from their origins as well as from some of their inherent capabilities, and if so, to what end? Increasingly, the desire to achieve greatness in microfinance is based on the same standards used in the private sector—success is about numbers and volume, efficiency, product, and productivity. Are NGOs in microfinance living in a for-profit, private-sector illusion?

Mann, Grindle, and Shipton (1989, 76), talking about well-managed development assistance organizations, say:

> . . .their greatest strength is their idealism and their skills in working with low-income and disadvantaged groups. Business skills must not be purchased at the cost of these qualities or the organizations will endanger their identity. The deep sense of commitment that motivates these institutions must remain their central feature.

And others, looking at the development field as a whole, also expect much. As economist Jagdish Bhagwati (1997) has said, "Those values [of civil society and of democracy] are better advanced . . . by the political and financial support of the numerous and growing NGOs, both here and abroad, that work ceaselessly to nudge the world in the right direction." But what is the right direction? And how does an NGO keep the pressures on it from subverting the organization's clear-sightedness about it?

And how does one maintain the kind of balance that Mann, Grindle, and Shipton (1989) expect? Few NGOs have been able to do this. In NGO microfinance, the tendency to go too far in one or the other direction (too unbusinesslike, or contrariwise, too businesslike) is pronounced.

How can management plan for the future, when donors and funders do not usually provide unrestricted core support, but instead continue to want to fund "projects"? And how realistically can NGOs work effectively and collaboratively with other organizations, when much of their effort has to go into creating a distinctive identity that will attract donors?

Naturally, the pressures, the questioning, and even the language of the new roles (the lexicon of banking) have had costs to internal morale. Many NGOs in microfinance ask themselves: Are we "hard" or "soft"? Who is our audience? Who is our primary constituency? How do we present ourselves to donors, to our publics? Our clients? Our beneficiaries?

A More Sensible Division of Labor

This paper has pointed to the poor record of NGOs on the sustainability and outreach front, the lack of hard evidence of poverty reduction as the result of their work in microfinance, the limitations of the microfinance market in which NGOs try to work, the inherent multiple challenges of poverty, the organizational challenges of NGOs in microfinance, and finally has suggested that NGOs have not learned as well as they might from the lessons of development history.

One could argue that microfinance is a young field, that failure is to be expected, especially of organizations with little experience, and so on. In the face of the argument that NGOs have embraced too simplemindedly the notion that credit is a key to poverty reduction one can argue that of course most organizations know that credit alone is not a panacea.

It is not that no NGO should engage in microfinance. Or that some sincerely engaged NGOs should not be allowed a learning curve. Nor, certainly, that credit should not be made available to and accessible by the poor.

Rather the paper is an attempt to highlight a number of problems with the NGO involvement in microfinance. First, there is a disturbing bandwagon effect at present that encourages poor practice and threatens to reverse whatever good microfinance is accomplishing, and this bandwagon effect is a product of an undue ballyhooing of microfinance (as witnessed by the Microcredit Summit in 1997), in which both donors and NGOs are complicit. Second, development assistance funds seem to be subject to a zero-sum calculus. To the extent

[11] Two examples: (1) The role that Dominicans living in the United States may play in the informal microenterprise economy of the Dominican Republic seems not to be brought out in ADEMI's analysis of its role in the economy. (2) In the case of the ABA in Egypt, the fact that Egyptian overseas workers in 1996 sent home US$6 billion, an enormous sum, and the role that may play in stimulating jobs is not considered when analyses of ABA's market are undertaken.

microfinance is what donors want to fund more of, it will usually mean funding less of something else. If that calculus is at the expense of more complex (and less sexy) investments in what used to be called enterprise development, more lasting effects on poverty reduction will be foregone. Third, the main source of illusion (and exaggeration) in NGO-run microfinance thus far has been the unrealistic expectation of both significant outreach to the poor and sustainability. As a result, subsidy has become an across-the-board dirty word, which it should not be at all. Finally, we suggest a division of poverty-reduction labor based on a sensible assessment of comparative strengths and weaknesses of different institutions, and ask if it makes sense for so many NGOs to become involved in microfinance and for so many donors to believe in a comfortable fit between the two? A few NGOs having been pioneers and shown the way, would it not now be simpler and more cost-effective for donors to invest more in banks and credit unions as deliverers of microfinance? Why do we need NGOs to be nonbank financial intermediaries, especially when we see that banks (and credit unions) *can* reach the poor and that NGOs have at best not met our expectations in microfinance? The great majority of NGOs may well be better suited to other roles in support of microfinance. Social intermediation is one and a return to the many challenges of enterprise development is another.

The Social Intermediation Role

Social intermediation refers to a range of activities that prepare people to become good borrowers and savers; to better manage their own finances or their own financial groups and to help them to put whatever social capital they have to more productive use.

Social intermediation implicitly acknowledges that many poor clients of microfinance are simply not in position to use loans productively. Because social intermediation activities mean interacting closely with people at the grassroots, these activities are a good fit with the classic characteristics of NGOs. The trade-off of course is that such interventions are not likely to be financially self-sustainable. They need instead to be seen as human capital investments.

NGOs as Poverty Lenders: Letting Go of Full Sustainability

NGOs in microfinance need to decide what is most important: being sustainable lenders or reaching the poorest with financial services. If some NGOs want to reach the very poorest with financial services, they need to face certain realities. First, they should not delude themselves or others about what they are doing—it is poverty lending and not economic-development or enterprise-development lending. Second, they should realize what the likely impacts will be. Changes in people's lives will be immediate in terms of lightening the burdens of poverty, but small loans to the poorest will not bring many of them permanently out of poverty. Third, in the initial stages, NGOs in poverty microfinance will have to have subsidies to continue to operate. Only over time, and only if it becomes possible for voluntary savings deposits to be the basis for lending (a doubtful if not undesirable prospect for NGOs in most places), will sustainability be within reach.

Nonfinancial Roles in Support of Effective Enterprise Development

There *are* roles for NGOs related to constraints on economic productivity other than lack of access to credit. These roles are perhaps more important, probably much harder, and certainly less panacea-like, but they may well have more long-term pay-off. Moreover, few others are involved in these kinds of interventions. For these reasons, such new roles would make sense for only a minority of NGOs—those with a particularly good ear for local economic realities and those with an institutional culture of patience and perseverance.

One of the arguments for minimalist credit is that farmers and others already know what they need to know about business and are missing only credit. But in reality, they do lack quite a lot of information and knowledge. Joseph Stiglitz has said, "while peasants may, in many respects be rational, responding to market forces, they are not fully informed about the consequences either of their actions, or of the institutions through which they operate" (Klitgaard 1991, 36–37).

Small, poor, farmers and traders are not only not fully informed, but are often surprisingly ignorant of forces operating around them. A simple lack of information is a major and regular constraint in developing country marketplaces (Geertz 1978, 30).

Many if not most markets in developing countries are inefficient and unarticulated—the parts and the players do not intermesh as well as they could. People of course do their best in such situations, but this does not mean that the system works well.

The same can be said for many if not most microenterprises. They are inefficient and most of all exist in an unarticulated relationship with the local economy, and often in no relationship at all with a regional or national one. The entrepreneur suffers greatly from lack of knowledge and information.

By glorifying the microentrepreneur and the economic environment in which he or she operates and by believing that it all works mysteriously well, NGOs justify microcredit as the missing piece. But this is not the case, and again, many NGOs know this. Entire subsectors can and do go wrong. Robert Klitgaard (1991, 67) tells, for example, of a major failure in the Pakistani shrimp market:

> The competitive Pakistani shrimp market did not work well . . . and again a culprit was poor information and resulting distortions of incentives. Because the local auction did not reward fishermen for catching larger shrimp, they caught too many smaller shrimp, and both the catches and the revenues were less than optimal. The export market did not possess institutions to gauge and reward the quality of the shrimp of individual Pakistani processors. This allowed undersizing and other abuses such as the export of decomposed, filthy, and salmonella-infested shrimp to the United States, with the result that Pakistani shrimp exports were blacklisted by the U.S. Department of Agriculture (Klitgaard 1991, 67).

It is not hard to imagine a small, well-run, focused NGO taking on the task of working with both local fishermen and those who run the auctions to help deepen their understanding of the situation in which they find themselves and perhaps playing a role in creating the missing institutions. At the same time it is easy to see that such a project might not have clearly measurable inputs or outputs and might depend for success as much on interpersonal artistry as on technical expertise. And if it did work to change things, where is the glamour in such custom-made and complex solutions? Still, NGOs could take on such tasks.

A quarter of a century ago, Judith Tendler (1975, 12) wrote:

> Development know-how was spoken about as if it were like capital—a stock of goods

> capable of being transferred from its owners to the less privileged. But development knowledge is not simply a stock with transferable properties. The peculiar nature of the development task makes knowledge a product of the transfer experience itself . . . the transferred resource is both input and output of the transfer process.
> The rationale behind development assistance, in sum, causes donor organizations to surround themselves with a protective aura of technical competence . . . . This makes it difficult to generate the experimental environment necessary for their work.

If NGOs can recall a time when they were not afraid to experiment, when they were not embarrassed to admit that they did not have all the answers, they could put their natural capacities to these kinds of use. So far, though there has been a rising tendency to avoid broad experimentation and to seek answers to poverty that many NGOs should know are too simple to be true.

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Outreach and Sustainability of Savings-First vs. Credit-first Financial Institutions: A Comparison of Eight African Institutions

Julia Paxton and Cécile Fruman

Although informal financial arrangements have prospered in Africa for generations, the history of formalized microfinance in Africa is a more recent phenomenon. The 1950s and 1960s led to a proliferation of rural lending programs, sponsored by government development banks, that focused solely on the provision of subsidized credit. In the 1950s, the first credit unions and savings and loan cooperatives were established in rural areas. In contrast to the development banks, the emphasis of these institutions was on savings mobilization. Those who promoted the credit unions—most often socially oriented missionary and other groups that were working with a low-income membership base—thought it necessary to teach the rural population to save and had little faith in the ability of the members to pay back loans. In the 1980s, when replications of Bangladesh's Grameen Bank began to be tested in Africa using primarily donor funds to provide credit to a wide number of solidarity-group members, a heated debate was generated over the strengths and weaknesses of the savings-first approach and the credit-first approach.[1] Guy Bédard (1993) of the International Alliance of Cooperatives introduced the terminology of "warm money" to qualify the savings generated by the communities themselves, over which they had greater responsibility than over "cold money," the funds provided by outside donors. Many believed that programs relying on cold money could not become sustainable and that they encouraged delinquency. Promoters of credit-first programs, on the other hand, believed that savings-first approaches were too conservative and were not reaching the bulk of the underserved population of microentrepreneurs.

After years of debate, it has become apparent that both methodologies have contributed valuable lessons and innovations for reaching a more diversified clientele. For instance, women who traditionally represented only a small fraction of the members in cooperatives represent the main clientele of credit-first programs. In addition, savings-led programs have had success in reaching a largely rural clientele.

Practitioners from both sides have learned from one another, and over the past few years many institutions have started blending the two approaches. Numerous credit unions now provide loans to groups of clients, mostly women, without requiring savings. One example is FECECAM in Benin. Credit-first programs, on the other hand, are now actively

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Table 1. Regional characteristics.

Region	GNP per capita 1994 (US$)	Growth of GNP per capita 1985–94 (%/yr)	Adult illiteracy 1995 (%)	Population density (no./km2)	Rural population (%)
Sub-Saharan Africa	320	−1.2	43	24	69
East Asia & Pacific	460	6.9	17	106	68
South Asia	860	2.7	50	238	74
Latin America	3,340	0.6	13	23	26

Source: World Bank 1996.

seeking the means to mobilize savings in order to be less dependent on donor funding. The division between savings-first and credit-first institutions is becoming increasingly blurred. However, for the purposes of this analysis, the delineation between savings-first and credit-first institutions will be preserved.

The following study examines the extent to which savings-first and credit-first programs[2] throughout Africa have been able to move toward sustainability while reaching clients traditionally excluded from formal finance, including women, rural inhabitants, the illiterate, and the poor. The analysis focuses on measures of sustainability and outreach as well as their inter-relatedness for eight microfinance programs in seven African countries. Three of these programs are savings-led and five are credit-led.

Background

The Country Context

Creating strong and viable financial institutions in Africa is particularly challenging given the macroeconomic context. Sub-Saharan Africa has the lowest GNP per capita of any region of the developing world (table 1). Not only is poverty widespread, but the average income fell by 1.2 percent annually from 1985 to 1994. During the same period, other developing regions had positive growth of GNP per capita. Another obstacle faced by microfinance institutions in Africa is the high illiteracy rate of 43 percent. In addition, the population density in Africa is much lower than in Asia. Since 69 percent of the sub-Saharan population lives in rural areas, microfinance institutions are challenged to serve widely dispersed rural clientele in a cost-effective way.

This study examines microfinance institutions located in seven countries—Niger, Benin, Mali, Burkina Faso, Zimbabwe, Kenya, and South Africa. Within such a grouping of countries, a certain degree of macroeconomic heterogeneity is to be expected (table 2).

South Africa stands out as an anomaly in table 2, given that its GNP per capita is nearly 10 times that of the other countries in the study. However, it should be emphasized that South Africa has the most skewed income distribution as shown by the high Gini index. Years of apartheid have resulted in two separate economies: one resembling a developed country and the other an impoverished country. In Zimbabwe and Kenya, al-

[1] Savings-first institutions mobilize local deposits and then more gradually provide some of their members with loans. In contrast, the credit-first programs reach a wide group of clients initially by providing credit to each of their clients, often relying on donor funds. Typically, mandatory savings is a prerequisite for obtaining a loan, however voluntary savings is not an important component of the program.

[2] Some of the initiatives looked at still deserve to be called programs because they rely on donor funding and are not regulated financial institutions. Only one of the programs (K-Rep) has been transformed into a financial institution with little reliance on donor assistance; others (FECECAM, CVECA Pays Dogon) are in the process of becoming regulated institutions. However, in this paper we have used "programs" and "institutions" interchangeably.

Table 2. Basic economic indicators for seven countries.

Country	GNP per capita 1994 (US$)	Gini index[a]	Growth of GNP per capita 1985–94 (%/yr)	Inflation 1985–94 (%/yr)	Adult illiteracy 1995 (%)	Pop. density (no./km^2)	Rural population (%)
Niger	230	36.1	–2.1	0.2	86	7	87
Benin	370	n.a.	–0.8	2.9	63	47	68
Mali	250	n.a.	1	3.4	69	8	81
Burkina Faso	300	n.a.	–0.1	1.6	81	37	91
Kenya	250	57.5	0	11.7	22	45	84
Zimbabwe	500	56.8	–0.5	19.7	15	28	78
South Africa	3,040	58.4	–1.3	14.3	18	33	52

Source: World Bank 1996.

a/ Index of income distribution inequality.

though GNP per capita is not as high as it is in South Africa, income inequality is just as severe. It is important to point out that the microfinance programs operating in these three countries and analyzed in this study target poor clients whose economic conditions are similar to those found in the other countries studied.

Six of the seven countries studied had zero or negative growth of GNP per capita from 1985 to 1994, mirroring the Africa region as a whole. Only Mali had had a positive annual growth rate. The West African economies using a common currency pegged to the French franc experienced low inflation in the 1985–94 decade, while Kenya, Zimbabwe, and South Africa had inflation rates averaging 12 to 20 percent annually. The West African countries also stand apart with regard to adult illiteracy. The vast majority of the population is illiterate in West Africa compared with around one-fifth of the population in Kenya, Zimbabwe, and South Africa.

The population density of each of the countries studied is dramatically below the average for South Asia and East Asia and the Pacific. Niger and Mali in particular have exceedingly sparse populations, averaging seven and eight people per square kilometer, respectively. Most of the population in each country is located in rural areas.

Contrasting Approaches: Savings-first vs. Credit-first

Experience proves that neither the savings-first approach nor the credit-first approach is a fail-safe method of providing sustainable financial services to the poor. Indeed, programs of each type have collapsed in Africa while others have enjoyed considerable success.

Savings-first and credit-first financial institutions in West Africa have been examined by many authors. Among these, Graham (1994) concludes that either approach can lead to the eventual provision of sustainable financial services. He outlines several advantages of each approach:

Savings-first

- information advantages lead to effective screening/monitoring
- internal source of funds creates repayment incentive
- no loan targeting
- voluntary savings
- bank/client relationship developed first as depositor

Credit-first

- rapid set-up possible through use of donor funds and technical assistance
- large initial outreach
- rapid expansion

- avoids high transaction costs associated with savings
- may use groups to overcome information asymmetries

Several clear advantages of savings-first institutions can be identified. Often, savings-first programs operate in close-knit communities thus facilitating screening and monitoring of clients. Rather than granting loans ad hoc to everyone in a village, the savings-first programs are selective in deciding who is creditworthy. The creditworthiness of potential borrowers is established through information advantages present in the community and also through the depositor relationship with the bank. Because funds are internally generated, a strong incentive exists to repay loans since ones' friends and neighbors will be upset if they lose their savings.

Perhaps the most important advantage of savings-first microfinance institutions is that they encourage voluntary savings. The use of internally generated funds results in a cautious approach to lending and attention to sustainability. These institutions are compelled to increase profitability through sound banking practices, reduction of operating costs, and appropriate loan screening and monitoring (U.S. Agency for International Development 1991). Most important, by offering voluntary savings, these institutions are providing a much desired financial service to the poor who rarely have the opportunity to earn a positive return on their savings in a safe and liquid account.

A common criticism of savings-first programs is that they only target middle-income entrepreneurs and do not reach very poor people. Also, much more time is generally required to establish a savings-first program since it is necessary to first establish trust, educate participants, and allow adequate time to build savings. Some problems associated with the internal management of funds can arise such as liquidity management, voting inequities, and physical security of funds, corruption. Another criticism of the savings-first approach is that voluntary savings are costly to collect, especially when the transactions are small and frequent. The questions that arise from these criticisms are therefore: (1) Is outreach of savings-first programs limited to middle-income clients? (2) Given the slow process of mobilizing savings and the costs involved, can savings-first programs reach economies of scale and financial self-sufficiency?

One of the principal advantages of the credit-first approach is its ability to reach a large number of clients in a relatively short period because of its reliance on external funding and technical assistance. Rather than waiting for the internal mobilization of funds, credit-first programs are able to have a large initial outreach and rapid expansion through the use of external funding. Often, but not always, voluntary savings are not collected in credit-first programs thereby reducing the transaction costs of mobilizing internal funds. Another common feature of credit-first programs is that they organize clients into solidarity groups. These groups can be instrumental in overcoming information asymmetries, thus leading to effective internal screening and monitoring of clients in well-functioning solidarity groups.

Critiques of credit-first institutions emphasize the fact that their reliance on donor funding makes them inefficient and unstable and that they are not required to develop into formal financial intermediaries. Their governance structure is generally weak because leadership answers to donors rather than directly to clients, depositors, and borrowers.

However, it is widely recognized that depth of outreach tends to be in these institutions because loans can be targeted to very poor people and disbursed quickly. In comparing these institutions to savings-first institutions or programs, two questions can be set forth: (1) Does the perceived ability of these institutions to reach the poorest translate into a greater depth of outreach than in savings-first institutions? (2) Does the charitable/donor-driven character of these institutions prevent them or delay them from becoming financially sustainable institutions?

To examine issues related to the outreach and sustainability of microfinance programs in Africa, eight programs were analyzed. Obviously, such a sample cannot answer these questions definitively. Nevertheless, the data shed light on issues of outreach and sustainability for both credit-first and savings-first institutions.

Savings-First vs. Credit-First Programs

In an attempt to analyze savings-first and credit-first microfinance institutions, data from eight case studies performed by the World Bank Sustainable Banking with the Poor study were utilized. The case studies contain data ranging from 1995 to 1997 and encompass a wide range of methodologies, contexts, and performances.

Three savings-first institutions were included: credit union networks in Niger (CPEC) and Benin (FECECAM) and a network of self-managed village savings and loan banks in Mali (CVECA Pays Dogon). These institutions have many points is common. They are all member-based, and boards of directors and credit committees are elected from the membership. They are all highly decentralized with local credit unions or banks in small towns or villages. All three institutions mobilize savings from their members and use these savings to extend loans to their membership. In the credit unions, however, the requirements for savings are quite different from those in the CVECAs. In the credit unions, members can apply for a loan only if they have been saving for a required amount of time and the amount of their loan is proportional to the amount they have saved. Members may not draw upon their savings while they borrow from the institution. In the CVECAs, on the other hand, loans can be provided to all members, regardless of their current or previous savings, as long as the village bank has sufficient resources.

In all of the savings-led institutions, lack of savings seems to be a constraining factor for growth. Demand for credit is higher than the supply of savings. CVECA Pays Dogon has solved this problem by developing ties with BNDA (National Agricultural Development Bank). BNDA lends the village banks an amount proportionate to the savings they have mobilized, to the extent that they meet the criteria set by the network of village banks. For the past 8 years, BNDA has been lending from a donor line of credit. It is hoped that in the near future, it will be willing to lend to the village banks at its own risk, now that the banks have established an excellent track record. This experience demonstrates that there are beneficial ways of mixing warm money and cold money and that the introduction of cold money, if done well, does not discourage savings mobilization systematically.

Among the credit-led programs, PPPCR in Burkina Faso and the Get Ahead Foundation in South Africa use solidarity groups, K-Rep in Kenya and Zambuko Trust in Zimbabwe offer both individual and group loans, and CARE Kenya uses a village banking methodology. These institutions rely primarily on donor funds or commercial funds to onlend to their clients. However, most of these programs do require compulsory savings, either as a form of collateral or as a means of "educating" clients on the virtues of saving and of linking them with formal financial institutions.

PPPCR was established as a loose replication of the Grameen Bank. Like the Grameen Bank, PPPCR has a compulsory noninterest-bearing savings program generated through its group fund. At the granting of each loan, the clients contribute to a common fund that can take the form of a group or village fund. However, confusion exists about the role of a savings fund versus an insurance fund. Sometimes the entire village fund has been used to cover the arrears of a few groups and has not been returned at the end of the loan. At one point, PPPCR decided to collect voluntary savings, but the savings were returned to the clients when new personnel implemented program changes. This violation of trust, plus instability, will make future savings mobilization more difficult, although this remains one of PPPCR's future goals.

Care Kenya, the Get Ahead Foundation, and Zambuko Trust do not offer voluntary savings products but do require mandatory savings. Care Kenya requires borrowers to save 20 percent of their loan amounts, a sum that is held by the program until the loan has been repaid in full. Get Ahead Foundation and Zambuko Trust require that their borrowers deposit 10 percent of their loan principal into an insurance fund prior to receiving their loan. At Get Ahead Foundation, borrowers are also encouraged to save in their account (opened at a local bank) each month so that if they apply for a repeat loan that is larger than the first, they will already have 10 percent of their new loan amount in their account. Zambuko Trust is considering changing its legal status to be able to mobilize savings. K-Rep, in its Juhudi (group) loan program, also encourages members of the group to contribute toward a group savings fund that serves as collateral for loans and broadens the members' business capital base. Once every year, Juhudi borrowers can withdraw up to 10 percent of their savings plus interest earned. K-Rep considers savings mobilization a process of empowering poor entrepreneurs by facilitating a gradual but steady accumulation of cash assets. In the long run, K-Rep, with the consent and collaboration of clients, hopes to use these deposits as capital by converting the fund into equity or loan capital fund capital.

Not only do the requirements for savings products vary substantially between the savings-first and credit-first institutions, but the deposit sizes also vary (table 3). Deposit sizes are much larger among savings-first institutions: US$93 (weighted average) in comparison with US$22 for credit-first institutions. This is not surprising, given that the savings-led institutions offer voluntary savings instruments while the average deposit size of the credit-led institutions is a reflection of the mandatory savings requirement.

Other basic institutional features of these institutions are also quite different (table 3). The savings-first programs were founded earlier (1984, on average, compared with 1986 for credit-first programs). The two credit unions in this survey actually are much younger than most credit unions worldwide. The average date of founding for credit union movements studied in a recent World Bank

Table 3. Basic characteristics of eight African microfinance institutions.

Institution[a] and year founded	Country	Clients (no.)	Avg loan (US$)	Avg loan vs GNP per capita (%)	Avg loan term (months)	Avg deposit (US$)	Avg savings vs. GNP per capita (%)	Growth of loan portfolio 1994–95 (%)
				Savings-first				
CPEC,1990	Niger	5,000	151	66	5	36	16	478
FECECAM, 1977	Benin	166,000	408	110	9	96	26	50
CVECA, 1986	Mali	21,495	136	54	6	94	38	64
				Credit-first				
CARE, 1983	Kenya	12,000	33	13	18	7	3	329
K-Rep, 1984	Kenya	12,451	350	220	12	38	15	107
Zambuk, 1992	Zimbabwe	2,197	180	36	8	18	4	70
PPPCR, 1988	Burkina	10,000	59	20	6	3	1	177
GAF, 1984	South Africa	9,865	171	6	6	45	2	125

a/ Data presented is for 12/94 for CPEC, 7/96 for FECECAM, 12/96 for CVECA, 3/97 for CARE Kenya, 12/96 for K-Rep, 8/95 for Zambuko Trust, 12/96 for PPPCR, and 6/96 for GAF (Get Ahead Foundation).

inventory was 1968, compared with 1983 for credit-first programs (Paxton 1996). In general, the microfinance institutions in Africa tend to be younger than those in other regions of the world.

One of the most striking differences between the savings-first and credit-first programs is their scale. The former tend to be much larger. Savings-first institutions average 64,000 clients in contrast to 10,000 for the credit-first institutions. This is an interesting finding, given that credit-first programs have an initially wide outreach. These savings-led institutions have been able to reach large numbers of clients despite their reliance on internally generated funds.

In addition, the terms and conditions of loans offered vary. Average loans are somewhat larger among savings-first institutions (US$222 compared with $159 for credit-first institutions). The average loan terms and the growth rate of the loan portfolios were comparable in both types of institutions.[3] The rapid growth of loan portfolios across the board in these African institutions raises some concern as the programs attempt to manage rapid growth with sound financial practices and sustainability.

Outreach

Von Pischke (1991) describes a frontier between the formal and informal financial sectors. Those outside the frontier do not have regular access to formal financial services. They comprise a heterogeneous population, where the degree of exclusion from financial services may vary and their distance from the poverty line (in either direction) in their respective countries may differ (Hulme and Mosley 1996). In measuring institutional outreach, it is important to distinguish between *extent* (or breadth) and *depth* of outreach—the former accounting for the absolute number of households or enterprises (or relative market penetration) in the target population reached by the institution and the latter indicating how deep in the pool of the under-served the institution or program has been able to reach.

Depth-of-Outreach Index

In developing countries, several categories of people consistently have been under-served by financial institutions.[4] These categories, usually bearing some degree of positive correlation across them, include the poor, women, rural inhabitants, the uneducated.

The poor. Formal financial intermediaries experience relatively high transaction costs when dealing with very poor people because of the small size of each transaction. For instance, the cost of offering savings facilities to clients who make frequent micro-deposits can be quite high. The same applies for very small loans, which in formal financial institutions require the same bureaucracy as larger loans, but capture very little rent, resulting in losses.

Women. Women have been excluded from formal financial services for a variety of reasons. Perhaps foremost is cultural bias against women. At the household level, most financial decisions have been made by male heads of household, although this cultural norm is shifting gradually. In addition, women represent some of the poorest people in developing countries. Their microenterprises and petty trade do not have sufficient scale to interest formal financial intermediaries. Finally, literacy requirements have barred some illiterate women from obtaining formal financial services. Female clients have been targeted by microfinance institutions not only because of their exclusion from formal finance, but also because women spend a greater percentage of their share of household income on food, children's clothes, education, and health than men do, as demonstrated in several studies (for example, Hopkins, Levin, and Haddad 1994).

Rural inhabitants. Because of the high transactions costs associated with serving a largely dispersed population and the high risk associated with agriculture, formal financial intermediaries have avoided rural areas. However, this negligence is particularly alarming in sub-Saharan Africa where approximately 70 percent of the population lives in rural areas. Government-sponsored programs that offer rural credit have been disappointing because of their reliance on subsidized interest rates, inappropriate terms and conditions, lack of repayment enforcement, and corruption.

The uneducated. People who cannot read and write face an obvious obstacle to obtaining financial services that require any type of written application or paperwork. This problem is especially pronounced in sub-Saharan Africa where half of the adult population is illiterate. Microfinance institutions have served the illiterate by adopting innovative techniques including oral training and screening, pictorial training, group guarantees, and use of thumbprint signatures.

These categories are used here to define and measure a depth-of-outreach index (DOI) for the institutions under analysis. The categories were chosen not only for their association with the degree of exclusion from financial services, but also for their relative ease of measurement in simple, rapid-appraisal surveys of the programs' clienteles. Other variables (such as ethnicity or national origin) could be used in different scenarios, depending upon the factors perceived as determining exclusion.

The variables are calculated on a 0 to 1 scale. For three of the variables (urban, male, and literate), the scale indicates proportion. A value of 0.5 for urban, for example, would mean half the population is urban. The income variable is based on GDP divided by the economically active population rather than on GDP per capita. The country average for this measure was

[3] However, the average growth rate of the savings-first institutions included in this sample is skewed upwards by the exceptionally high growth of the Niger credit unions. This high growth can be explained by the fact that the program was very young and only started granting loans in 1992. Most savings-first institutions grow at more conservative rates.

[4] This section draws upon Paxton and Cuevas 1997.

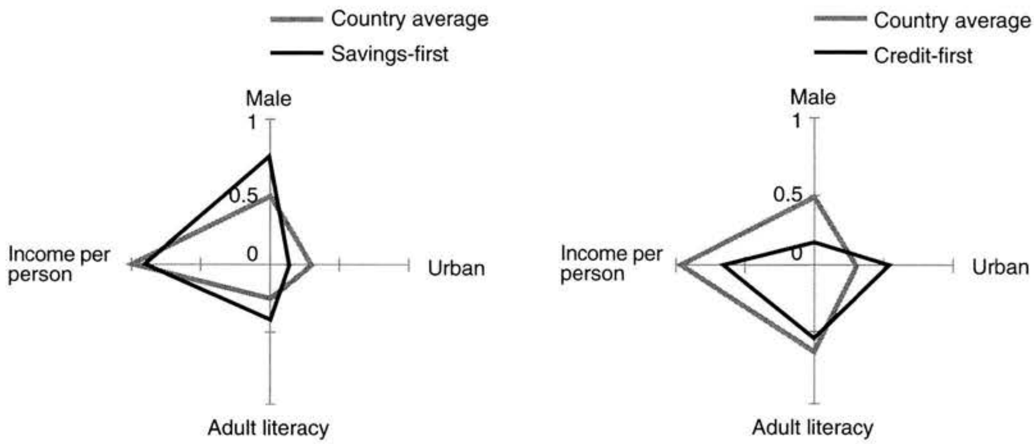

Figure 1. Outreach indices for savings-first and credit-first institutions, based on the clientele's average income and proportion that is male, urban, and literate.

normalized to a value of 1. The income of the clients was put on the same scale by dividing the average income of the clients by the country-level income.

Depth of Outreach in the Case Studies

The DOI is used to analyze the degree to which credit-first and savings-first financial institutions serve rural, female, poor, and illiterate clients. Depth-of-outreach diamonds were constructed to examine these four outreach indices of credit-first and savings-first institutions in comparison to the overall country averages (fig. 1). The diamonds present a simple graphic representation of the four outreach indicators. Smaller diamonds reflect a greater depth of outreach.

The country averages give a general benchmark for comparison for the savings-first and credit-first averages. The credit-first diamond generally is smaller than the country average diamond, representing a deep outreach, while the area of the savings-first diamond is roughly equal to that of the country-average diamond. This finding parallels those of a similar study on Latin American microfinance institutions (Paxton and Cuevas 1997).

Furthermore, among the savings-first institutions, the average clients tend to be more literate and male than the country average. Many credit unions have a predominantly male membership, although in recent years more female members have joined African credit unions. In addition, credit unions have been active in literacy training in Africa. On average, savings-first membership is slightly poorer and much more rural than the country averages.

In contrast, the outreach diamond for credit-first institutions shows an entirely different clientele. On average, the credit-first programs target a more urban, female, illiterate clientele than the country average. Urban market women represent a large percentage of credit-first clients. The incomes of these clients is nearly one-half the average income per economically active worker in the country. In this respect, it is clear that the credit-first programs have a significant outreach to underserved portions of the community.

While the outreach diamonds for savings-first and credit-first institutions in figure 1 show institutional averages, disaggregated diamonds for each individual institution would show additional detail and variation. Among the savings-first institutions, CVECA in Mali stands out as having a deep outreach in terms of reaching the very poor, women, and rural inhabitants. PPPCR and CARE Kenya have a notable depth of outreach among the credit-first programs. Because of the income inequalities present in South Africa, the Get Ahead Foundation serves a much poorer population than the country average, although this contrast is not as pronounced when examining only the black population of South Africa.

Sustainability

Although it is useful to examine to what degree microfinance institutions reach beyond the traditional financial frontier, the ability of microfinance institutions to reach large numbers of clients with financial services in the long run is a function of their financial viability. A program that reaches the very poor but relies solely on donor funds is wasteful in several ways. From the donor perspective, it uses scarce resources inefficiently. From the institutional perspective, it creates an external dependence for the financial institution. From the client perspective, the perception of impermanence and the use of external funds rather than internally generated funds creates incentives to default. Not only does the outreach of the credit-first and savings-first institutions differ, but the sustainability varies dramatically from one institution to another (table 4).

One of the most revealing indicators of institutional sustainability is the subsidy dependence index (SDI) (Yaron 1992). The SDI measures by what percentage interest rates charged to clients would have to be increased hypothetically to cover program costs and eliminate subsidies. To correctly calculate the SDI, *all* expenses should be accounted for, including those that do not appear on the financial statements. These expenses include goods and services for which a microfinance institution does not pay but that are important to the conduct of its business, e.g., a rent-free building, consultant fees, a donor-paid technical advisor. Other costs that go unreported are subsidies provided by governments or

Table 4. Sustainability indicators for eight African microfinance institutions.

Program (and year of study)	SDI[a] (%)	Self-sufficiency (%) Operational[b]	Financial[c]	Arrears rate (%)	Portfolio at risk (%)	Real effective interest rates (%)	Loan officer salary vs GNP per capita (%)	Ratio of savings to loans[d] (%)
Savings-first								
CPEC (1994)	3,675	204	n.a.	28	n.a.	48	n.a.	206
FECECAM (1995)	70	106	74	2	2	13	3	148
Mali CVECA (1996)	78	94	67	2	2	34	0.4	41
Credit-first								
CARE Kenya (1996)	1,900	26	26	9	14	38	12.8	20
K-Rep (1995)	140	98	n.a.	8	15	33	14.4	19
Zambuko Trust (1995)	238	60	60	31	54	21	7.2	10
PPPCR (1995)	126	43	n.a.	2	n.a.	20	2.3	5
Get Ahead Foundation (1996)	n.a.	n.a.	35	14	33	44	2.2	20

a/ Subsidy dependence index: the percentage that interest rates charged to clients would have to be increased to eliminate subsidies.

b/ Operating income divided by operating costs.

c/ Operating income divided by the sum of operating and financial costs.

d/ Volume of savings divided by volume of loans outstanding.

donors such as tax deductions or subsidized lines of credit. In calculating the SDI, it is important to estimate the shadow price of these subsidies—what the institution would have to pay if it paid taxes as a formal financial institution does and if it raised funds on the local commercial markets.

For most of the institutions in this sample, it was difficult to estimate all of the hidden costs in order to calculate the SDI precisely. Many programs had no idea of the costs of the technical assistance being supported by the donors, and other programs refused to share this information, fearing to appear badly in the comparison. As a result, the SDI measures presented table 4 are not fully reliable. In particular, the SDI values for several credit-first institutions appear to be underestimated. The fact that microfinance institutions have not been concerned in the recent past with tracking down all their costs is in itself is an interesting result. It proves that they have considered donor and government assistance as a given. Only in the recent years have some institutions come to understand that, to be less vulnerable to changes in policies and fund allocation, they must start paying the full cost for all the goods and services they receive.

Among the savings-first institutions, both CVECA Pays Dogon and FECECAM appear to be on the road to sustainability. CVECA Pays Dogon has plans to become financially self-sufficient within a few years now that foreign technical assistance is no longer required and only the local costs need to be covered. It will have taken this program 12 years to become a sustainable institution. FECECAM may need to wait a few more years, given that an ambitious development plan has been elaborated by management and the expansion costs will keep the institution in the red until all of the newly established credit unions become profitable.

The Niger credit union movement (CPEC) has a very high SDI because the institution is young and has generated little revenue to cover the high start-up costs. In addition, the SDI measure for CPEC fully accounts for all additional costs including training and development that is support by the World Council of Credit Unions. Although 37 local CPECs had been established by December 1994, the total loans provided since inception of the program in 1990 did not exceed US$158,000. The SDI figures of these three savings-first institutions seem to demonstrate that savings-first programs can reach financial self-sufficiency over a period of 10 to 15 years, but in their first years of existence these programs have very high SDI figures because of important start-up costs.

For the credit-first institutions, SDI figures ranged from 126 percent for PPPCR to an alarming 1,900 percent for CARE Kenya. Part of the reason for CARE Kenya's high SDI is that its microfinance program has only recently focused on financial viability. In the early years of its operation, the microfinance program was viewed somewhat as an experiment and fit into the rest of the subsidized humanitarian effort of CARE Kenya. Only since 1996 has the Women's Economic Development microfinance program split from the rest of CARE Kenya in order to strive for a higher degree of financial sustainability. Although PPPCR's SDI values do not include some foreign technical assistance, they have improved steadily during the 1990s.

Since the case study of K-Rep was conducted, the institution was close to reaching break-even in 1997 and was transformed into a licensed bank, with equity participation from foreign investors such as International Finance Corporation (part of the World Bank Group), African Development Bank, and Shorebank. In contrast to K-Rep, CARE Kenya's SDI measure indicates severe obstacles to sustainability. As for Get Ahead Foundation, the first financial statements of its financial unit, Get Ahead Financial Services (GAFS), were elaborated in 1996. Because accounting of GAFS had not been differentiated from the other services offered by the NGO until that year, a great deal of confusion existed and it was impossible to calculate the SDI.

Other measures of sustainability generally are more favorable for the savings-first programs than for the credit-first programs (table 4). Operational and financial self-sufficiency measures tend to be much higher for the savings-first programs. For two credit-led programs, CARE Kenya and Zambuko Trust, operational and financial self-sufficiency measures are equal because these programs rely on donations and do not have financial costs.

No clear pattern emerges when examining arrears rates (table 4). Five of the eight programs have arrears rates below 10 percent of the outstanding loan portfolio. The high arrears rate of the Niger credit unions is composed almost entirely of arrears of less than 60 days. Zambuko Trust has experienced poor repayment rates in the past couple of years, leading to a portfolio-at-risk measure of 54 percent in 1995. The portfolio-at-risk measure of 33 percent for the Get Ahead Foundation also raises serious concerns. Poor recovery of loans not only hurts the measures of self-sufficiency, but endangers the immediate survival of the program.

The more favorable sustainability measures of some savings-first institutions is in part a function of the attention to cost. Although real effective interest rates are on average similar for the two approaches, the savings-first institutions have lower labor costs than do the credit-first institutions. The average starting salary of a loan officer in a savings-first program is 1.7 times the GNP per capita, a stark contrast with the credit-first programs, which offer starting salaries averaging 7.8 times the GNP per capita. Most important, the savings-first programs rely on member deposits to support their lending activities rather than on donor funds. The ratio of the volume of savings to volume of loans outstanding for savings-first institutions averages 132 percent compared with only 15 percent for credit-first programs. To fund their credit activities, credit-first programs rely principally on donor funds, which in turn results in high SDI measures.

Outreach vs. Sustainability: Mutually Exclusive Goals?

A common presumption in the field of microfinance is that a trade-off occurs between outreach and sustainability. For example, it is assumed that institutions that target the very poor must rely on subsidies while financial institutions that are completely financially sustainable do not have incentives to serve the poor because the relatively high costs of small transactions hurt the institutions' bottom line. Indeed, a recent study of rural member-based financial institutions in Latin America found a strong positive correlation, 0.633, between depth of outreach and subsidy dependence (Paxton and Cuevas 1997). To examine whether this relationship held for the African credit-first and savings-first institutions, outreach and sustainability measures were plotted together in figure 2.

The values for the depth-of-outreach index (DOI) in figure 2 were derived from outreach diamonds constructed for each

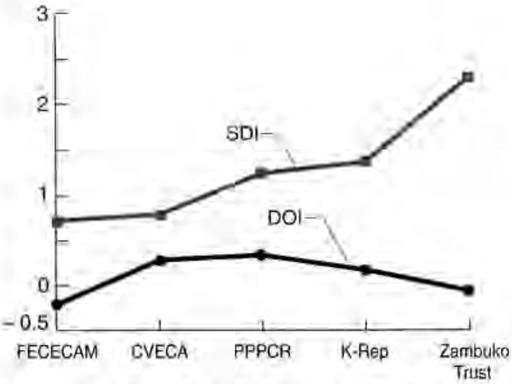

Figure 2. Depth of outreach index (DOI) and subsidy dependence index (SDI) for five microfinance institutions.

country by calculating the area of the country-average diamond and subtracting the area of the institutional outreach diamond. Thus, a positive number indicates that the institution serves a clientele that is more rural, poor, female, and illiterate than the country average. In figure 2, this index value is compared with the SDI measure for each institution. Because of the very high SDI values for CARE Kenya and CPEC in Niger, these institutions are omitted from the figure to avoid distorting the scale. As in the study of Latin American institutions, depth of outreach was positively correlated with institutional reliance on subsidies. For six African institutions, the correlation between the DOI and the SDI was 0.61.[3]

Even though some parallels exist between dependence on subsidies and depth of outreach, outreach and sustainability are not necessarily mutually exclusive goals. Variation exists within the sample of African institutions. Among the savings-first institutions, FECECAM and CVECA have similar SDI levels, yet CVECA has a deeper outreach. Likewise among credit-first programs, K-Rep and PPPCR at the time they were analyzed both had similar SDI levels, but PPPCR has a deeper outreach.

In general, it is incorrect to assume that institutions that have a deep outreach cannot be sustainable and vice versa. For example, the FECECAM credit union movement is the most sustainable institution in this study. While it also has the second lowest depth-of-outreach index, it is noteworthy that it serves a large cross section of clients including those traditionally excluded from formal finance. FECECAM served 166,000 clients in 1996. Calculated on just the poorest third (still an impressive 55,000 clients), the depth-of-outreach index would rival that of the credit-first institutions, which have outreach as a primary goal.

None of the institutions in this study had SDI measures as low as zero, indicating that a dependence on subsidies exists across the board. Most programs that have shown a certain degree of competence in serving the African poor have been heavily subsidized by the donor community. For microfinance programs operating in difficult contexts, sustainability need not be an elusive goal. Although some programs remain far from attaining sustainability, others show promise of becoming financially sustainable. In addition, these programs tend to be quite young and have continued to make strides toward sustainability. Over time, the SDI measures for each of the institutions studied have steadily improved.

Conclusions

Sub-Saharan Africa has proven to be one of the most difficult milieus for creating and maintaining sustainable microfinance institutions. Among the three savings-first and five credit-first

[3] The correlation also includes CARE Kenya, which is not displayed in figure 2, given that its very high SDI measure did not fit the scale of the figure. No SDI measure was available for the Get Ahead Foundation and therefore it was not included in this part of the analysis.

institutions examined for outreach and sustainability, none, to date, have been able to cover the costs of subsidies despite inroads toward financial viability. Two savings-first institutions, FECECAM and CVECA, stand out as having achieved the lowest dependence on subsidization, while the credit-first institutions demonstrate a more notable dependence on subsidy.

Through an analysis of client characteristics, it is evident that the credit-led institutions have a deeper outreach. Credit-first programs have a more female, illiterate, and impoverished clientele than the average population of the country. In contrast, the savings-first clients are more rural and only slightly poorer than the country averages. Their clients, however, tend to have a greater concentration of educated males than the country average.

A positive correlation between dependence on subsidies and sustainability was documented using six of the case studies. Nevertheless, this finding does not support the notion that institutions with deep outreach cannot be sustainable or that sustainable institutions cannot have a deep outreach. First, each institution studied has made progress over time in improving its institutional sustainability. In addition, some financially viable institutions have a large enough scale that the poorest part of their clientele has similar socio-economic characteristics to institutions that specifically target those outside of formal finance. In sum, the most important lesson is that a wide variety of market niches exists in the field of microfinance. Although institutional viability is critical, the exact composition of clients can vary from one methodology to another. An institution that is successfully reaching a wide number of depositors and borrowers in a sustainable fashion is contributing greatly to the development process.

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Fourteen Years of Enterprise Development in Kenya

Henry Oketch

K-Rep is a microfinance institution serving the poor in rural and urban areas of Kenya. It is registered as an NGO under the Nongovernmental Organizations' Coordination Act. This status will soon change, though, because K-Rep is licensed to convert part of its current microfinance activities into a commercial bank for the poor. The rest of K-Rep will continue as an NGO but with greater emphasis on microfinance research and innovations and on building the capacity of other microfinance institutions in the region.

Although credit has always been part and parcel of commercial banking, granting loans to the poor has seldom been thought of as an opportunity. Commercial banks and other formal financial institutions in most African countries have ignored or avoided the demand for credit and other financial services by the poor. Banks still shy away from it to this day. Obviously, it is not due to lack of need or demand; the demand has always been there. The poor and weak have always outnumbered the rich and powerful. More significantly, the attempts of the poor to become richer are a recurring theme in history. Credit can often help; unfortunately, it has not always been available (Fernando 1995).

Unfortunately, the few NGOs, government agencies, and donors that have tried to make financial services accessible to the poor shows have found it to be a difficult and expensive task. Yet, if the economic potential of the poor æwho are the majority in African countries æis to be realized, their economic activities must be financed. This paper documents the experience of K-Rep in making financial services accessible to the poor.

Establishment and Evolution

Since 1990, K-Rep has successfully transformed grants from its development partners (U.S. Agency for International Development, DFID, Ford Foundation, Canadian International Development Agency, and others) into loan capital for nearly 30,000 businessmen and women. It has been able to do so at a positive return since 1994 (table 1). K-Rep has disbursed over K Sh 300 million each year since 1995 and has never run short of new customers.

K-Rep was begun in 1984 as a project of World Education, Inc., a U.S.-based private voluntary organization. It wasestablished as an intermediary NGO to provide financial and technical assistance to NGOs in Kenya that are involved in developing or promoting the development of micro and small enterprises.

Since the inception of K-Rep, its mission has been to empower low-income people economically and socially so that

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Table 1. K-Rep lending and returns, 1993–97.

Year	Annual loan advances (K Sh millions)	Profit (K Sh millions)
1993	84	–4.6
1994	211	5.8
1995	376	1.7
1996	315	31.3
1997	305	2.1

they can actively participate in the development process and enhance their quality of life. K-Rep ultimately seeks to alleviate poverty and increase employment and income opportunities for the poor through the development and promotion of appropriate financial systems and mechanisms and by strengthening the capacity of other microfinance programs and institutions.

K-Rep was locally incorporated as Werep Ltd. in 1987 (the name changed to K-Rep in 1992) under the Companies Act as a company limited by guarantee. This move represented an important step in establishing K-Rep as an independent Kenyan NGO. The legal status of K-Rep changed again in 1992 when it complied with new legislation that required private development organizations to register under the NGOs Coordination Act.

K-Rep has similarly changed its strategies with time and experience. From 1984 to 1990, K-Rep was preoccupied with building the capacities of other NGOs—that dealt directly with micro and small enterprises—by making grants to them, providing training and technical assistance, and supervising their management and governance. During this 6-year period, K-Rep supported 12 NGO microcredit programs and nearly 48 group-owned income-generating projects, popularly known as CBEs. Most of the NGO microcredit programs were add-ons to other social welfare programs. Consequently, it was difficult for the 12 NGOs to provide adequate management support to the microcredit component of their welfare activities. The CBEs, for their part, proved to be poor credit risks, generating little impact and few benefits to individual members and too often creating leadership and management problems among group members. Yet this large number of NGOs and CBEs provided an excellent environment for K-Rep and USAID/Kenya to explore new and better ways to run microfinance business for the poor.

In 1987 an evaluation of K-Rep by USAID/Kenya identified the potential conflict to the institution of seeking to expand its outreach while at the same time exploring and testing new means of enterprise development. The evaluation recommended transforming K-Rep from a project into a local institution as the only way to guarantee and preserve its impact and the benefits of 6 years.

Later in the year, four K-Rep senior managers traveled to Asia and South Africa to learn from the experiences of the Grameen Bank, BRAC, and the Get Ahead Foundation. Following the trip, a new corporate vision and strategy was defined. Among the major changes was a decision by K-Rep to develop its capacity to make service-linked income. In retrospect, this was a key step to ensure the long-term survival and eventual independence of K-Rep.

The broad corporate strategy was reflected in policies and activities developed in 1989. Only four grant agreements were renewed in 1989, but even these had new financing structures and arrangements. First, each grant agreement had an in-built monitoring, audit, and evaluation budget line. Second, each budget had a break-even analysis and a projection of costs and revenues over a 3-year period. Third, the financial reporting requirements specified in the grant contracts were clearly focused on measuring the progress and financial performance of the NGOs around costs and income from lending.

K-Rep eliminated funding of training and technical assistance from all its grant agreements but instead increased the allocation of loan capital. Any other provisions for training and technical assistance budgets were allocated directly to the two departments within K-Rep that were functionally responsible for training and research or monitoring and evaluation.

Financial assistance to NGOs, which previously had been given in the form of a 100 percent grant, was changed to 70 percent loan and 30 percent grant. The 10-year loans carried a 7 percent interest rate, but NGOs were allowed to charge higher rates.

In 1990, partly to test first hand whether this new financing mechanism was workable and partly to deal with its own demands for future survival, K-Rep broadened its program beyond NGOs by launching its own direct-lending program, the Juhudi Credit Scheme. Between 1990 and 1994, K-Rep pursued these two tracks—working with NGOs and operating the Juhudi Scheme simultaneously—using the minimalist methodology with both. Because of a huge success in the first 12 months of experimenting with group-based lending, K-Rep shifted to wholesale lending to money-go-round groups on behalf of and for the benefit of their individual members. What is now popularly known as the Chikola credit scheme was first tried in 1991 following the success of the Juhudi and NGO credit schemes.

K-Rep's Broad Palette

In addition to providing microcredit, K-Rep engages in a wide range of other activities.

Research. K-Rep has carried out many studies on the informal sector in eastern and southern Africa, some in conjunction with government ministries and others with development organizations. The 1993 and 1995 GEMINI nationwide surveys of small, micro, and medium-size enterprises (in which K-Rep provided the lead in field organization and logistics) remain the definitive reference on the informal sector in Kenya. As K-Rep has become more institutionally focused on expanding its direct lending programs, its research has become more oriented toward the analysis of issues related to its methodologies.

Consultancy. K-Rep provides consulting services to organizations in Africa with microfinance schemes. Consultancy is provided in the following areas: design of microfinance programs, institutional capacity building, needs assessment, evaluation of program, research on development issues related to micro and small enterprises and microfinance.

Innovations and development of microfinance products. K-Rep pilot tests innovative microfinance products, system, and mechanisms.

Arifu Center for Information and Documentation. K-Rep operates a specialized documentation center for development issues related to micro and small enterprises and microfinance.

Capacity development for grassroots microfinance organizations. This activity is linked to the development of innovative microfinance products—grassroots groups involved in pilot testing of new products are trained in implementing the schemes.

By 1994, K-Rep had expanded its direct credit program to five branches and nearly 15 field offices. Because of the pressure and demands placed on the organization by this expansion, K-Rep redefined its corporate vision and structure. K-Rep realized that a disproportionate amount of management attention and time was being devoted to lending at the expense of other equally important activities (see box). It was further realized that, if too much emphasis were given to lending, many high-risk, high-yield opportunities that would be possible from research and innovation could be lost or passed over.

Furthermore, K-Rep made a strategic decision to phase out its role as a grant-based intermediary NGO, but at the same time it created a full-fledged department to provide training, capacity building, and technical support to other microfinance institutions on a request-and-fee basis. These changes were reflected in the creation of two divisions, one for financial services and one for nonfinancial services, each headed by a deputy director. This divisional structure allowed the management to focus exclusively on direct lending, on one the one hand, and external support to other institutions, on the other.

Through 1997, K-Rep disbursed over 36,000 loans worth US$25 million (table 2). Net mandatory savings mobilized from the groups as part collateral reached US$10 million over the same period.

Table 2. K-Rep loans, 1990–97.

	Loans	
Year	No.	K Sh millions
1990	123	1
1991	1,320	13
1992	1,939	23
1993	4,331	84
1994	5,149	211
1995	11,137	364
1996	6,223	315
1997	5,805	305
Total	36,027	1,300

Shift to Commercial Banking for the Poor

The success of the credit program motivated K-Rep, as early as 1994, to consider the possibilities of converting its poverty lending into a commercial banking for the poor. But this was not the only reason.

Management Capacity

The first challenge was to balance management time between financially sustainable lending activities and broad-based nonfinancial services. K-Rep realized that it could not continue to expand its lending activities without crowding out other program activities that are not financially sustainable but that are more in tune with K-Rep's original social mission. The nonfinancial services such as technical support to partner institutions; training, research and evaluation; and innovation and development are primarily public goods with limited possibilities of becoming self-supporting. They are, therefore, at a disadvantaged position in competing for management attention with lending activities.

K-Rep's response to this challenge was to separate the management of the financially sustainable activities from the nonsustainable, but developmentally valuable activities, by establishing a new institution with a broader and different legal mandate in the financial services industry and shift direct lending activities to it. Theoretically, this separation could have been achieved within one institution, without having to create a new one, but that would have complex financial, board, and regulatory implications. The option of setting up different institutions, within one organization, was more attractive.

Legal and Institutional Capacity

The second challenge was the question of legal and institutional capacity to provide microfinancial services optimally. The legal and institutional framework of an NGO in Kenya is not well suited to a microfinance operation. It may be the best environment for experimentation and product development, but it is clearly limited in scope for providing financial services on a large scale. A microfinance institution cannot legally provide saving instruments unless it is registered under either the banking or the cooperative act. Even where the law is silent or permits NGOs to provide financial services, they are rarely considered to be serious financial institutions by public and commercial banking institutions. Institutionally, therefore, the opportunity for an NGO to participate effectively or to develop innovative systems and products (such as commercial paper and other debt instruments) is limited.

K-Rep's response was to establish an institution that has the legal and institutional capacity to further its microfinance work. After considering all possible options, K-Rep decided that establishing a commercial bank was the best course.

Precedent for NGOs Becoming Banks

The field of microfinance was pioneered by specialized NGOs and commercial banks such as BRI in Indonesia, Grameen Bank in Bangladesh, and Prodem/BancoSol in Bolivia among others. They have demonstrated that populations traditionally excluded by formal financial institutions can in fact be a market niche for innovative banking services that are commercially viable in both credit operations and deposit mobilization. Microfinance represents a significant departure from earlier attempts to make credit available to the poor through financial institutions (often public institutions) at subsidized rates with low recovery rates. Successful microfinance institutions are largely local organizations that reach an underserved market and are commercially viable.

K-Rep believes that the future of micro-lending will largely depend on the ability of financial intermediaries in this sector to tap the resources available in the local market. The potential to mobilize savings is significant. The experience of microenterprise credit programs that have converted to banks amplifies this point. BRI, for example, has three times more savers than borrowers.

Funding Issues

With time K-Rep experienced a larger demand for loans than it was likely to be able to finance with donor funds. It became clear that K-Rep had to establish a long-term funding strategy that would be reliable and less costly but capable of tapping into the local financial market.

Establishment of an Organization that the Poor Can Rely On

Conventional development organizations seldom address the question of creating private demand-driven institutions to carry out development activities. Microfinance has, however, been an exception. Instead, development interventions attempt to increase incomes of poor people, with the hope that they will progress to a level where they can be served by mainstream institutions. K-Rep believes that the strategy of creating alternative institutions to help poor people organize their lives financially is an innovative approach, which could result in a significant development impact.

Moral Concerns

The K-Rep bank will provide an alternative to commercial banks that are committing an injustice by siphoning off poor people's savings to capitalize bank loans for wealthy clients while redlining poor peoples' requests for credit. In Kenya, NGOs committed to poverty alleviation are legally prohibited from holding savings deposits, which are the largest source of cheap loan funds for mainstream lending institutions. NGOs must now deposit the savings of their clients in banks whose procedures are obstacles to achieving the economic empowerment aspirations of the poor people. Banks with good credit ratings multiply their available financial assets by leveraging funds from capital markets at a rate of 1 to 13 compared with 1 to 1 for NGOs using donor funds. K-Rep will be 13 times more effective in operating as a deposit-taking bank than as a donor dependent than NGO operates.

Challenges and Future Direction

Based on an internal assessment of its lending activities, K-Rep has recognized that it has left out significant sections of the poor. Although the Juhudi and Chikola credit schemes have proved effective in reaching the poor, they have nonetheless generally failed to reach the bottom quartile of the poorest members of the society. The poor face a highly diverse range of financial needs and opportunities that need to be addressed. Since 1996 K-Rep has redefined the configuration and mandate of its former nonfinancial services division to deal with this challenge. The newly defined K-Rep NGO is committed to combining the advantages of microenterprise credit with strategies to reach the very poor.

Microcredit and microfinance, two terms that are gaining currency in the development literature, reflect the fact that financial issues facing the poor are much broader than those presented by micro and small enterprises alone. K-Rep is creating a bank dedicated to microcredit and an NGO that has already started to experiment with savings and credit schemes for financing health, housing, farming, and educational needs of poor families. This marks a new phase of institutional development and program activities for K-Rep in pursuit of its mission.

K-Rep has formulated a strategic plan to be implemented over the 1997–2001 period (K-Rep 1997). Under the plan, the objective of the Microfinance Research and Innovations (MFRI) Program is to identify, test, and develop new microfinance systems, products, mechanisms, and instruments for the poor. A second and more important strategy is to establish appropriate institutions (or help other organizations to do so) that can deliver such services. This strategy looks beyond microenterprise and microfinance but seeks to adapt microfinance principles that have worked for micro and small enterprises.

The areas of MFRI experimentation, currently in various stages of development, include user-owned, -managed, and -financed savings and credit schemes, health care financing for the poor, a microfinance project for smallholder dairy farmers, a renewable energy financing project, a microfinance project for smallholder crop production, and a low-cost housing finance scheme for the poor.

The second part of the plan, the Capacity Development Program, aims to help develop the capacity of grassroots, user-owned and -managed microfinance schemes so that they can better manage their microfinance activities. K-Rep intends to assist grassroots microfinance organizations in Kenya by providing training and technical assistance to NGOs and community-based organizations with microfinance activities, by promoting NGO collaboration, and by participating actively in networks. To increase the capacity for microfinance development, K-Rep will also operate a 1-year management internship program for women graduates and a 3-month internship for students in institutions of higher learning.

Other capacity-building activities will involve consultancy services (a separate business plan has been prepared) in various aspects of microfinance development, the Arifu Microfinance Information Center, and an exchange visit program.

A major challenge facing K-Rep and other microfinance development organizations in Africa is how to expand their operations. Most microfinance institutions in Africa have less than 20,000 clients. The small scale of operation limits their ability to achieve financial sustainability. Microfinance organizations must therefore strive to achieve high volumes of loan advances and savings.

For microfinance organizations to develop and transform themselves into institutions that provide microfinancial services effectively and sustainability, a supportive policy and regulatory environment is essential. Given the need to create alternative financial institutions that devote their energy to providing financial services to the poor, regulatory bodies must establish new and appropriate legislation for microfinance development institutions. This will legitimize microfinance institutions and give them the prominence and image that is desired. Apart from encouraging the development of alternative financial institutions, regulatory policy is required to protect the fast-growing microfinance industry from illegitimate operators out to make quick money. Lastly, as is being argued by Kimanthi Mutua, the managing director of K-Rep, it is not sensible for any financial market to allow unregulated financial organizations to operate freely.

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Les Caisses Rurales d'Epargne et de Prêt of Benin

B. Glehouenou and M. Galiba

Insufficient credit is one of the leading ills that agriculture suffers in sub-Saharan Africa, because it hinders adoption of improved practices that raise yield. Agricultural development requires the existence of a credit system capable of supporting production by farmers through the acquisition of inputs and other factors of production. Professor Yunus, founder of the Grameen Bank, affirms this by saying, "It is through access to credit that the small farmer can enter the battlefield of the vicious economic war. To ask him to engage in this battle without access to credit is to take him to certain defeat." This is the context in which the strategy employed by Sasakawa-Global 2000 in Benin since 1989 must be viewed. SG 2000 has chosen cooperative action in support of agricultural extension. The essential approach consists of forming associations of producers for technology transfer.

This paper discusses SG 2000 and the question of agricultural credit during the initial phase, the advent of CREPs (Caisses Rurales d'Epargne et de Prêt), and the results obtained.

SG 2000 and the Question of Agricultural Credit

From 1989 to 1992, SG 2000 established partnerships with groups of farmers in Benin to introduce improved production practices and to ensure that credit was available to support purchase of needed inputs. In this activity, SG 2000 provided initial production credit to the members of a group who would repay the loan after harvest in cash or in kind. The proportion of credit SG 2000 supplied to each group progressively declined over a 3-year period: SG 2000 provided 100 percent of the needed credit in the first year, 50 percent in the second year, and none in the third year. Higher incomes from the new farming methods allow the group members to assume the burden of providing input credit in the third and subsequent years.

The record of repayment by small-scale farmers is shown in table 1. When the technology is profitable, the farmers repaid the credit used. The repayment rates demonstrate that farmers are creditworthy; however, credit should be accompanied by a sound extension program to train farmers to apply new technology successfully.

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Table 1. Repayment rate (%) of input credit, 1989–92.

Department	1989	1990	1991	1992
Atacora	100	98	93	75
Atlantique	91	92	86	82
Borgou	100	100	97	94
Mono	100	100	90	87
Ouémé	100	83	90	80
Zou	100	94	91	87
Avg	98	95	91	84

Table 2. CREP locations.

Department	CREPs (no.)
Ouémé	24
Mono	6
Atlantique	7
Zou	32
Atacora	10
Borgou	14
Total	93

In effect, the extension strategy put in place by SG 2000 through this credit scheme has permitted a remarkable increase in food production and income. Small-scale farmers today recognize that winning the production struggle calls for inputs that they cannot acquire without credit. A financing mechanism at the village level is required.

The main purpose of the CREPs is to ensure that financial assistance is locally available to farmers, allowing them to buy the inputs essential for improved agricultural husbandry. From the inception of SG 2000's technology transfer project, SG 2000 that considered motivating farmers to mobilize resources for a mutual loan scheme was vital for the sustainability of introduced technology.

The Advent of CREPs

Genesis of the CREP network

Technology transfer demands financial arrangements that commercial banks do not want to offer to small-scale farmers because they regard rainfed agriculture as too risky. Consequently, to support the diffusion of innovations in rural areas, SG 2000 had little alternative but to promote the creation of CREPs as autonomous sources of financing.

The origin of CREPs goes back to 1992 when the Association of Savings and Credit Cooperatives of Africa, the Ministry of Rural Development, and SG 2000 agreed to combine their efforts to provide an efficient system of credit for producers. A feasibility study demonstrated the need for local savings and loan banks run by village members themselves.

Results

By March 1998, the CREP network in Benin consisted of 93 savings and loan associations (table 2), which had 17,051 members and over CFAF 30 million of paid-in equity. Table 3 shows how the membership evolved.

From CFAF 49 million in 1994, the total amount of deposits grew 15-fold by 1997 (table 4). This remarkable expansion has continued, as shown by the results recorded during the first quarter of 1998.

As shown in table 5, the network started at less than CFAF 2 million of credit in 1993 and reached CFAF 214 million in 1997. By the end of 1997, over 7,000 loans totaling CFAF 426 million had been granted over 5 years. The perfect recovery rate obtained from 1993 to 1996 is solid proof of farmers' creditworthiness whenever loans are invested in income-generating activities.

Reorganization of CREPs

When a single village is able, on its own, to mobilize more that 70 percent of the CREP deposits of a department, there is a question of whether the money saved was from that village alone or whether some money also came from other villages. CREPs possess an iron safe, which is

Table 3. Growth of membership and paid-in equity in CREPs, 1992-98.

Department	1992–94	1995	1996	1997	1998[a]	Cumulative[a]
			Members (no.)			
Ouémé	532	459	1,001	1,915	197	4,104
Mono	438	1,222	722	488	202	3,072
Atlantique	72	52	118	626	80	948
Zou	269	947	1,239	1,904	374	4,733
Atacora	267	20	463	177	132	1,059
Borgou	548	652	260	1,108	567	3,125
Total	2,126	3,352	3,803	6,218	1,552	17,041
			Capital (CFAF millions)			
Ouémé	0.84	0.92	2.00	3.63	0.36	7.7
Mono	0.79	2.44	1.34	0.96	0.40	5.9
Atlantique	0.14	0.68	0.16	0.97	0.21	1.6
Zou	0.53	1.85	2.62	3.72	0.74	9.5
Atacora	0.47	0.48	0.40	0.84	0.20	2.0
Borgou	0.99	1.47	0.46	2.22	1.13	6.3
Total	3.75	6.80	6.99	12.33	3.05	33.0

a/ Through March 1998.

Table 4. Growth of deposits (CFAF millions).

Department	1992–94	1995	1996	1997	1998[a]
Ouémé	13.8	69.8	133.7	214.5	139.4
Mono	11.0	108.7	160.5	17.0	109.4
Atlantique	1.0	1.5	1.2	5.5	0.8
Zou	9.7	24.0	88.5	169.5	37.7
Borgou	2.7	5.7	5.1	14.2	5.0
Atacora	11.1	68.6	73.4	356.3	400.8
Total	49.3	278.3	462.4	777.0	693.0

a/ Through March 1998.

a powerful attraction for farmers and small-scale market venders concerned about the loss of their hard-won savings through theft or fire.

Because savings also come from other villages in a district, it is crucial to know how much each village contributes. It would be inequitable for the savings of one village to be used to serve the needs of another village. This issue is significant because mobilized savings are the main source of loans, and each CREP is limited to lending no more than 30 percent of the savings it holds. To avoid such pitfalls, it was decided to reorganize large CREPs.

Successful CREPs attract members from many villages. But at the point when the CREP's size makes it difficult to manage, MEPs (Mutuelles d'Epargne et de Prêt) are created. Each MEP corresponds to one village and has a limited number of members. All the MEPs in one district get together to form a CREP, at which level the safe is located. Some characteristics of MEPS:

- The assets of the MEP comprise the total deposits of its members.
- The available balance of the MEP is the difference between the total deposits and the total withdrawals.
- Credit granted to members cannot exceed the base of the available assets of the MEP.
- Keeping money secure through the safe is the main linkage with the CREP, which holds all the deposits. In return a MEP can make withdrawals at any time to fulfill its members' needs.

Table 5. Credit growth through December 31, 1997.

Department	1993	1994	1995	1996	1997	Cumulative
			Loans (no.)			
Ouémé	36	121	268	484	707	1,616
Mono	8	41	250	79	329	707
Atlantique	7	12	5	60	182	266
Zou	25	123	183	172	1,321	1,824
Borgou	–	99	196	452	1,165	1,912
Atacora	7	53	213	295	308	876
Total	83	449	1,115	1,542	4,012	7,201
			Amount (CFAF millions)			
Ouémé	0.7	5.6	24.4	47.9	70.5	137.9
Mono	0.3	2.3	35.6	21.9	6.0	61.1
Atlantique	0.2	0.6	0.2	0.9	6.2	8.1
Zou	0.5	2.9	16.3	13.0	61.3	93.9
Borgou	–	5.6	13.8	22.7	59.6	101.7
Atacora	0.04	0.7	5.8	6.5	10.2	23.3
Total	1.8	17.6	96.0	113.0	213.8	426.1

The goal of the reorganization is to keep members in close proximity to facilitate communication and reinforce solidarity. This strengthens bonds of togetherness within in a spirit of federation characterized by financial autonomy and freedom of action suited to each MEP.

Figure 1 shows that the MEP is a section or a branch of the CREP endowed with the same bodies as the CREP (general assembly, administrative council, credit committee, supervision council). There is however a functional relationship between CREP and MEP.

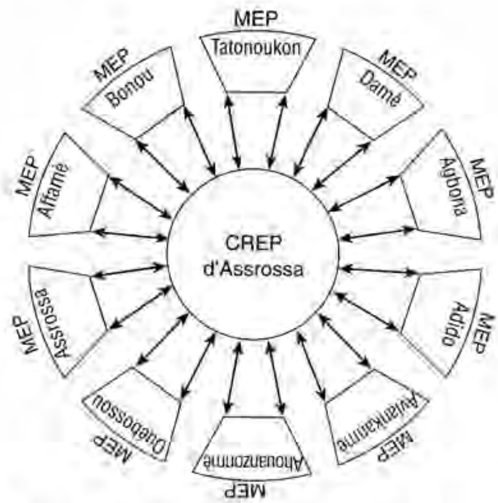

Figure 1. Relation of MEPs to the CREP.

Financial Analysis and Prudential Ratios

Three CREPs—Assrossa, Atomey, and Toviklin—were chosen as examples of the operations of individual CREPs during the period from 1996 to 1998. Assrossa has a large membership divided into MEPs. Its annual deposits exceed CFAF 20 million. Atomey is a rapidly growing CREP and has annual deposits between CFAF 10 and 20 million. Toviklin has a high female membership and annual deposits under CFAF 10 million.

Membership

The CREPs of Assrossa, Atomey, and Toviklin have a total of 2,790 members (1,171 women and 1,619 men) out of a population estimated at 101,370. Women represented 42 percent of members at the end of 1998 compared with 36 percent in 1996 (table 6). Membership increased significantly for all three CREPs; however Toviklin more than doubled its membership from 1997 to 1998.

Table 6. Membership growth in three CREPs.

	1996		1997		1998	
CREP	Total (no.)	Women (%)	Total (no.)	Women (%)	Total (no.)	Women (%)
Assrossa	948	36	1,272	36	1,761	37
Atomey	–	–	345	28	538	25
Toviklin	–	–	217	75	491	80
Total	948	36	1,834	39	2,790	42

Table 7. Growth in savings in three CREPs, 1996-98.

	Deposits (CFAF millions)			Annual growth (%)		
CREP	1996	1997	1998	1996	1997	1998
Assrossa	29.6	55.2	66.2	68	87	20
Atomey	–	6.2	13.6	–	–	119
Toviklin	–	1.2	6.9	–	–	460
Total	29.6	62.7	86.7	68	112	38

Savings

Savings in the three CREPs grew each year with a peak of 460 percent in Toviklin. The retention rate of clients in the three CREPs is 100 percent. Table 7 shows that the creation of new CREPs causes the deposit growth rate to increase to 38 percent in 1998 against 20 percent for Assrossa alone in 1998.

Loan Portfolio

Lending to the 10 largest borrowers rose from CFAF 4.9 million to 5.1 million in Assrossa (table 8). The risk assumed is limited to 0.9 percent in 1998, much less than the recommended norm of 10 percent. The risk is 3.7 percent at Atomey and 17.5 percent in Toviklin. Despite the case of Toviklin, one can assume that loans are spread as much as possible to all members within the limit of available money.

Loans to managers were just 4.6 percent in 1996 and 4.8 percent in 1997, considering all three CREP together. These values are far below the limit of 20 percent accepted by the Central Bank of West African States. It is a sign of good governance by CREP managers.

The quality of the portfolio can be determined by the percentage of outstanding loans in arrears reported to the total loan portfolio. The ratio normally accepted is 2 percent and it should not exceed 5 percent. As the balance of loans with payments past due is zero, the portfolio of all three CREPs are healthy.

Table 8. Total loans (CFAF millions).

CREP	1996	1997	1998
	10 largest borrowers		
Assrossa	4.9	5.1	5.1
Atomey	–	0.8	2.4
Toviklin	–	–	3.7
Total	4.9	5.9	11.2
	Managers		
Assrossa	1.4	2.6	2.5
Atomey	–	0.3	1.3
Toviklin	–	–	0.3
Total	1.4	2.9	4.0

Profitability

Profitability is reached when operating expenses are smaller than operating income—a ratio smaller than 1. Among the three CREPs analyzed only Assrossa shows solid signs of profitability 3 years in a row (table 9). Profitability is a long-term goal for most decentralized financial structures. Assrossa started in 1992 and

Table 9. Profitability ratio.

CREP	1996	1997	1998
Assrossa	0.94	0.58	0.41
Atomey	–	2.91	2.65
Toviklin	–	1.66	0.99

struggled until 1996 to cover operating expenses. Toviklin which achieved a ratio of 0.99 in 1998 is on track.

Conclusion

The CREP experience is not over. The road to fully attaining the objectives that started the movement is still long. However the determination and will of thousands of small-scale farmers eager to bring a positive and lasting change in their environment is evident. With hard work, dedication, and a strong sense of purpose, they know they will succeed if they can put time on their side. The Assrossa case is a shining ray of hope. More CREPs will follow and by their efforts and good results will be able to attract more partners to take on the challenge of making credit available to all rural people.

Human Resource Management in Microfinance Institutions

Nabil A. El Shami

Institutional development in microfinance encompasses the individuals who compose the institution. The microfinance institution's approach to building a long-lasting human resource base emerges as one of its most challenging and important tasks. The process of building a productive staff can be divided into five areas: profile of the staff, administrative policies, selection and recruitment, incorporation of staff into the institution, and retaining good staff. The first two areas are guides for managing and developing staff; the rest are processes that strengthen human resource management.

Profile of the Staff

A microfinance institution usually starts with a staff of a few persons and gradually expands, sometimes doubling or tripling in size in response to the program's growth. Staff expansion involves hiring and training individuals to carry out tasks, and it is the most significant way in which the microfinance institution's vision is interpreted and applied. Four areas of contribute to establishing a clear profile of the staff: human quality, creativity, teamwork, and technical skills.

Human Quality

Each staff member must exhibit a gift for interaction with low-income people. This quality is often found in staff whose background lies in the social sciences and in social development work. In short, everyone on the staff must share a sense of commitment to both the institution and the people it reaches.

Creativity

Because the nature of activities in microfinance institutions requires a great deal of self-supervision, especially among the field staff, it is imperative to identify individuals who have the capacity to develop a creative, analytical streak in their work. An important part of incorporating individuals into the institution includes training in fine-tuning their analytical and creative skills.

Teamwork

As microfinance institutions grow, they develop small units of operation through branch offices. Each of these units must function as a team to carry out its work in an effective manner. Often, team-building skills must be present in the upper and middle management levels before they can be instituted among field workers.

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Technical Skills

In microfinance institutions, the staff must acquire varied skills. The field workers, for example, may have only a high-school education or may have completed their university degree only recently. To work in microenterprise programs, staff need skills in community development, as well as in finance for credit provision and management. On-the-job training characterizes much of the field worker's activity. After 1 or 2 years, this person can be well versed in microenterprise development and engage in training and technical assistance as well. For other positions, however, technical knowledge is paramount. Staff in the financial and the computer departments, for example, must demonstrate considerable expertise in their fields in order to carry out the roles required by the microfinance institution.

Administrative Policies

In the early stages of program growth, a microfinance institution should develop personnel policies and clearly spell them out in a manual. A growing program requires quick hiring of persons to fill a variety of positions. There should be written policies on which to base selection and recruitment activities, which should be reviewed annually. They should, at least, include:

Guidelines to personnel policy. These include how an institution hires personnel, taking into account labor laws and other codes in each country.

Job description. Each position in the institution must include a clear definition of responsibilities.

Salary policy. The range of salaries for all positions, including the benefits package and other factors should be included.

Incentive policies. Since most microfinance institutions pay relatively low salaries, some have incentive systems that increase an employee's income level. The system should link staff productivity with pay.

Evaluation of performance. Each microfinance institution requires an established system for assessing the quality of each staff member's work on regular basis. There are a wide variety of ways to conduct this task.

Recruitment and Selection

Hiring staff is a time-consuming task. The microfinance institution must have an established system for hiring, which can vary depending on the position under consideration. Especially in hiring field workers, there are several creative and productive ways of operating. For example, an institution intending to hire 20 or more field officers at the same time might run a newspaper ad that would yield many possible candidates. The number is narrowed to around 40 for initial interviews conducted by regional directors. These interviews further reduce the number of applicants to 30. These 30 applicants take a 10-day training course in microenterprise assistance, which allows them to be closely observed in the areas of personal interaction, technical skills, capacity to work with others, initiative and creativity, and other important assets that are difficult to capture in interviews. By the end of the 10 days, the institution identifies the most promising candidates for the field officer positions and in the process has already trained them for their work. The remaining candidates—now around 25—will receive on-the-job training in the branch offices during their probation period. They apprentice with experienced field officers to carefully observe the interaction between the field officer and his clients and to learn policies and procedures in detail. If they appear to be progressing well, they will be asked to develop a few new clients, and if the judgment applied to these applications is sound, they will be finally hired and assigned a permanent coverage area to serve.

Incorporation into the Institution

Once the institution has hired its staff, the most demanding task is the integration of the staff into the institution. Staff training is one of the most powerful and important methods for accomplishing this. Two major types of staff training are most appropriate for human-resource development in microfinance institutions. The first, training in analytical thinking, seeks to provide tools for analyzing and solving problems. It utilizes the daily work experience of the staff as the point of entry for its content. Specific aspects of their work such as program promotion or delinquency issues are discussed using a process of analytical thinking that helps new staff members understand the cause and the solutions in each case. The second type of training emphasizes technical skills. In microenterprise programs, technical skills relate to a variety of activities including calculating interest rates, developing simple profit-and-loss statements, interpreting computer printouts, and assessing program impact. The staff should receive periodic upgrading of financial and other technical skills. Other activities, such as training outside the organization and exposure to programs in other countries, complement the human-resource development function of an institution.

Retaining Good Staff

Low staff turn-over is an important objective for microfinance institutions. Turn-over is strongly correlated with compensation and incentive systems. It is painful for microfinance institutions to lose staff members because they invest heavily in training staff to understand the products they are delivering and to provide high-quality service. Since a microfinance institution can keep its staff only if the staff member wants to stay, the primary issue is how to build institutional loyalty.

Basic Package

The basic package for reducing turnover:

- Invest heavily in training.
- Give the staff the responsibility for making their own decisions as appropriate to their positions.
- Pay a base salary that is equivalent to the prevailing wage scale.
- Offer substantial incentives for good performance that is clearly measurable.
- Emphasize the relationship between accountability and incentives.
- Provide an attractive career path.

Job Satisfaction

An important route to staff retention is through good service to the client. A significant part of job satisfaction comes from the knowledge of the staff that they are liked and respected by many people. The trust that develops between clients and staff should not be underestimated in building the kind of job satisfaction that enables the institution to retain its good staff.

Staff Incentives for Good Performance

Staff retention is enhanced by substantial, performance-based incentives of various types, which are given regularly for good performance that is clearly measurable. In Egypt, the Alexandria Business Association (ABA) has, from its inception, linked staff productivity with pay. The result has been a win-win arrangement, with highly motivated staff on the one hand and very efficient operations on the other. The following section describes the staff incentive schemes of ABA.

Staff Incentive Schemes

ABA's Small and Microenterprise Project is a financially sustainable non-profit organization, which is in the process of establishing a for-profit investment company to assume its credit activities. ABA only offers individual loans, it does not offer group loans or savings services. Most of its clients are men, and the majority of them are involved in manufacturing. Three-quarters of the borrowers have micro-loans (US$300 to $900) and one-quarter have small loans (US$1,500 to $7,500). Microenterprises are defined as those businesses with up to five employees, while small businesses have 6 to 15 employees. In November 1997, ABA had over 13,500 borrowers in Alexandria and nearly 800 clients in Kafr El-Sheikh where it had recently established operations.

Newly hired extension officers all have university degrees. Extension officers at ABA are paid a base salary equivalent to the prevailing wage of civil servants in Egypt, about US$40 to $45 per month. However, this salary is insufficient to make a living. To generate sufficient income, civil servants typically hold second and third jobs. For field staff, ABA offers a lucrative monthly incentive scheme that allows them to earn up to five times their basic salary in incentives depending on their productivity.

Extension Officer Incentive Scheme

For extension officers, the incentive scheme consists of three variables: the number of accepted loans, the repayment rate, and the number of active clients. These variables delicately combine portfolio quality and quantity to ensure that quality is maintained while the organization continues to expand. For quantity, ABA emphasizes the number of clients rather than portfolio size to avoid encouraging field staff to offer larger loans. The compensation for these variables is presented in table 1 and table 2.

Table 1. ABA monthly incentive scheme based on number of accepted loans provided by extension officer.

Accepted loans (no.)	Incentive (US$)
15–19	9.00
20–24	15.00
25–29	24.00
30–34	32.50
Over 34	45.00

Table 2. ABA monthly incentive scheme based on repayment rate.

	Incentive (US$)			
Repayment rate (%)	70–90 clients	91–120 clients	121–150 clients	Over 150 clients
97.0	27	40	45	52
97.5	31	45	49	56
98.0	36	50	53	62
98.5	42	56	58	68
99.0	48	67	65	74
99.5	57	82	74	83
100	71	36	89	100

Table 1 shows the monthly incentive earned by extension officers based on the number of approved loan applications, both new and repeat. Extension officers who generate 35 or more approved loans in a month, they will earn an additional US$45, which is double their base salary. If they generate fewer than 15 approved loans, they do not earn an incentive from the schedule in table 1. There is an additional bonus for extension officers who generate more than 10 new loans per month.

The schedule in table 2 shows how ABA balances its rewards for quality (repayment rate) and quantity (active clients). Extension officers with repayment rates below 97 percent or with fewer than 70 clients do not earn any incentives from the schedules in either table 1 or table 2.

The relationship between these two variables is in part designed for fairness—it would be unfair for extension officers with more clients to earn the same quality incentives as their peers with fewer clients, if they had the same portfolio quality. But the schedule in table 2 also serves as an encouragement for extension officers to increase their number of active clients.

The quality requirements in this incentive scheme may seem too strict. But ABA believes this strictness is critical to sensitize staff to the importance of maintaining near perfect portfolio quality. And it is achievable. Approximately two-thirds of ABA's extension officers have 100 percent repayment rates each month. The high quality expectations have a profound influence in the extension officers' client selection process. If they earned incentives with an 85, 90, or even 95 percent repayment rate, then they might not be as concerned about client selection as they are knowing that each month their portfolio quality must be between 97 and 100 percent to qualify for *any* incentives. Since the incentives form a large portion of their potential salary, not qualifying for incentives is fairly painful.

Incentives for Other Staff Members

ABA also offers incentives for branch managers, branch lawyers, and back-office staff. Branch managers receive incentives in a grid similar to table 1, based on the number of active borrowers per extension officer and the repayment rate of the branch. Each branch also has a lawyer who assumes responsibility for all past due loans. The lawyers receive incentives based on the amount of past due installments collected during the month. Collection fees of 2 percent for amounts up to US$1,500 and 3 percent for amounts greater than US$1,500 encourage aggressive collections.

Table 3. ABA incentive scheme for back-office staff (relative to base salary).

Criteria	Incentive (%)
Loans processed (no.)	
800–1,000	65
1,001–1,200	70
1,201–1,500	75
1501–1,800	80
1,801–2,100	85
2,101–2,500	90
Over 2,500	95
Overall repayment rate (%)	
97.0	20
97.5	30
98.0	40
98.5	50
99 or more	60

ABA offers incentives for office staff, including employees in the management information systems, accounting, and personnel departments. For these staff, it is much more difficult to assess the quality and quantity of their performance than it is for field staff. Since the volume of loans processed each month reflects the relative workload of back-office staff, ABA uses this as the primary variable in calculating their incentives. In addition, to emphasize the importance of portfolio quality on the overall health of the organization, they also receive a smaller incentive based on ABA's overall repayment rate (table 3).

Benefits of the Incentive Scheme

There are two sets of benefits from this incentive scheme: financial and nonfinancial. For employees, the most significant financial advantage is that they receive higher pay. ABA's large ratio between base salary and potential incentives makes this feature particularly compelling. Field staff who can earn 20 or 30 percent of their salary in incentives will not be nearly as motivated to achieve the established targets as employees who can earn four or five times their base salary.

For the institution, since the scheme is linked directly to performance, ABA benefits from higher productivity, increased net income, and better portfolio quality. These factors made it possible for ABA to achieve operational sustainability 2 years after it began lending and to become financially self-sufficient 2 years later. The incentive system also helps the organization to achieve one of the most efficient operations in the microfinance industry. In 1996, ABA's administrative expenses were 8.2 percent of average outstanding balance. For ABA, the net financial benefits of higher productivity greatly exceed the financial costs of the incentive scheme. This point is critical in any incentive scheme, and microfinance organizations should carefully conduct analysis and make projections to establish the viability of the scheme before introducing it on wide scale.

The nonfinancial benefits of the incentive scheme accrued by the institution and its staff are almost as important. The incentive scheme allows ABA to establish clear performance objectives with staff. Performance evaluation is therefore easily carried out, based on the accepted standards outlined in the scheme. This transparent relationship between performance and compensation results in high levels of staff motivation and job satisfaction. At the same time, this form of compensation quickly identifies staff who are unable to perform at acceptable levels. Nonperforming staff usually resign if they cannot earn sufficient incentives since the base salary alone is not enough to live on.

Building Lateral Learning Networks: Lessons from the SEEP Network

Alain Plouffe

Networking has a vital role in the development of the microfinance industry. Finding or creating a suitable to serve the needs of a specific group or organization or to attain a specific goal is a demanding task. This paper describes different forms and roles of networks, looks in detail the functioning of the SEEP network, a lateral learning network, and gives some lessons learned.

Types of Networks

It is important to recognize that there are many distinct forms of networks. Some are informal, ad hoc groupings of organizations to reach some short-term goal or to react to a specific situation in their external environment. Some networks are more formal but have narrow goals and minimal means. Some networks take the form of an apex institution such as a federation or a union of NGOs or cooperatives. Some have more vertical ways of transmitting information and taking decisions. Still others have a lateral learning process where the exchange goes from organization to organization without having to reach the top of the network.

Some networks exist mainly to represent the members of the network, while other networks work primarily to share information and knowledge among the members. Finally, many networks pursue a wide variety of goals and are organized both vertically and laterally. They might be characterized as hybrid networks.

Five features help distinguish one type of network from another: goal, nature of members, formality, interdependence, and control. The contrasting ways these distinguishing features are managed can be illustrated by comparing a *learning network*, a *representation network* or supervision network, and a *financial intermediation network*.

Learning Network

In a learning network, the goal of member organizations is usually to exchange knowledge with other members of the network. Although network members have a common goal, they may have different methodologies and different clientele. Such a network can be formal or informal, minimalist or not. The level of dependence between the members and the network and among members is slight. Thus even if the network is important for the growth of its members, it is not crucial to their day-to-day lives. The level of

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control among members and inside the network is very limited, and there is little or no formal control.

Representation network

In a representation or supervision network, the goals of the member organizations are generally the same, and they respect a common set of standards and practices. Usually members are all looking for a certain kind of professionalization.

Members of such networks tend to employ similar methods and have similar levels of development. The member organizations commonly are more or less similar in age and size.

This kind of network must be formalized to be effective. The main purpose of the network is to represent the member organizations, and the formalization of the network is fundamental if that representation can be done on a political level or though links with a government agency such as the Central Bank.

At the beginning of such networks, the members' level of dependence on the network is quite limited. As the network gains representivity and is recognized by the local bodies of governance, the level of dependence grows and after a few years becomes very important. All members have to agree to a code of conduct and usually are controlled by the network.

Financial intermediation network

In a financial intermediation network, all members have the same goals and are similar to each other. The network is formalized and recognized by the local government. The level of dependency between members and the network is high, and the life of each member of the network usually depends on the viability of the network. Internal controls are common and external control is usually also related to the network. The more well-known form of financial intermediation network is an apex organization in cooperatives. This kind of network not only shares knowledge but also shares excess savings and can also manage external line of credit for the network members.

The SEEP Network

The Small Enterprise Education and Promotion (SEEP) Network is a lateral learning network. It is an association of more than 40 North American private and voluntary organizations that support micro and small enterprise programs in the developing world. The SEEP Network provides a forum for its members to engage in joint research and training and for the development and dissemination of publications for field use. Through these endeavors, it promotes professional standards of practice and serves as a center for communication and collaboration on a broad range of sector-related issues.

Since 1985 SEEP has built a community of agencies interested in and committed to a collaborative process of learning. Begun initially as a project under the umbrella of PACT, Inc., SEEP organized one of the first evaluation efforts in the enterprise development community and articulated a systematic approach to monitoring and evaluating the economic, social, and institutional dimensions of enterprise projects. The product of that work, *Monitoring and Evaluating Small Business Projects: A Step by Step Guide* (Buzzard and Edgcomb 1987), has sold over 6,500 copies in English, Spanish, French, and Bahasa Indonesia.

Building on this effort, the SEEP Network has gradually expanded its focus to incorporate research, product development, and training in credit program design and management, institutional development, poverty lending, business development services, training, and environmental linkages. It has initiated an information program that incorporates the systematic documentation of member programs and materials, and it issues a quarterly newsletter that reports on innovations, debates, new programs, events, and products relevant to practitioners.

Membership has increased from the initial 24 members to over 40. Together, SEEP's member agencies assist over 5 million people in Asia, Africa, and Latin America with their enterprise development assistance, expend roughly US$110 million on their behalf, and annually extend over US$700 million in loans.

From its perspective as an association of NGOs in industrial nations that have links throughout the developing world, SEEP has observed the growing need for strong and capable institutions and the emergence of lateral learning networks as a key mechanism for assisting with their development. The concept of NGO networks is certainly not new. Nor are the challenges associated with it. Over the years, dozens of networks have faced difficult questions about how to galvanize members with limited resources to extend their efforts beyond the responsibilities of their individual programs. How can member organizations work together to respond concretely to their collective needs and sustain that responsiveness over time?

These questions are particularly relevant to lateral learning networks as opposed to affiliate networks or apex institutions in which members are linked operationally and financially.

Key Factors of Success

We consider that the key factors of success for a lateral learning network are vision, capacity, resources, and linkages. For each factor, we have learned through the years that it was necessary to follow some line of conduct to support the growth of the network and the development of its members and to prevent major setbacks in the network programs.

Vision

Vision is the ability of an institution to articulate and generate commitment to the mission, goals, and strategy that it pursues. For lateral learning networks, the most critical challenge is to ensure that member commitment and participation are constantly nurtured and supported through processes and structures that

- define and update the network's vision and goals
- establish programs, their goals and objectives
- set association policy

Lesson 1. Define the Membership

A lateral learning network is an association of members owned by the members, and the network is constitutionally bound to respect their will. The challenge is to translate this right of ownership into the lifeblood of the network. So for a lateral learning network to grow, it is important to have members who are eager to exchange knowledge with other members. The members must have similar interests and orientations. The SEEP Network, for example, does not accept government agencies, donors, or research and consulting firms as members. This policy facilitates frank exchanges among those linked by the common experience of carrying out programs in the developing world, which is highly valued by all members. The members also must commit to contributing staff time and travel expenses to the network and to pay annual dues.

Lesson 2. Equality

All members are equal and have only one vote and one representative in the annual meeting. Learning is to be generated through the pooling of experience across a variety of agencies and strategies. Any funds distributed by the SEEP to individual members for research, writing, training, and technical assistance activities must result in advances in learning or products that will benefit the larger community. It has to be clear that members are at the center of the network operations.

Lesson 3. Foster Member Engagement

SEEP's structures and processes provide a way for it to blend formal agency representation and active engagement by many staff of member agencies. This structure has four components: the membership of agencies, the Board of Directors, the working groups, and the staff.

Each member organization is part of the body of SEEP and must designate an official representative who acts as the principal point of communication between itself and SEEP. The members are invited and actually participate in setting policy through their participation at SEEP's annual meeting.

The SEEP Network is guided by a seven-member Board of Directors elected from the representatives of member agencies. Board members provide regular guidance and service to SEEP staff between meetings, as well as providing representation to all working groups.

The working groups, in many ways, represent the heart and soul of SEEP. Unlike the standing committees found in many association structures, these are ad hoc bodies established on the basis of member interest. Each working group is composed of 5 to 15 members and serves as the vehicle for participatory research, applied learning, documentation, and training on a particular topic. Each designs its own learning process and implements it with the support of SEEP staff. The working groups continue their efforts with the preparation of the written products that synthesize the substance of their discussions. Currently, the active working groups include financial services, poverty lending, training, evaluation, and business development services. Although many groups have existed for a long time, it is important to note that there is no statutory foundation for their existence. Groups form, dissolve, and re-form on the basis of member interest.

As this description implies, working groups are the creative cauldron in which SEEP generates its learning and crafts its products. They also are the place where program directions are identified and where critical network issues are discussed. Because they are open to all interested staff of member agencies, they facilitate much broader involvement in network decision making. One of SEEP's mottoes is that "program is decided by whoever comes to the table." The Working Group provides a venue where many interested individuals can put in their two cents, and shape the course that the network will take.

The SEEP Network has a small professional and administrative staff that supports the members in the execution of all program activities. Occasionally, these core staff have been supported by contract personal for short- or long-term projects, but in general, SEEP's work is managed by three people.

We have learned two things about staffing. First, the network should be member driven, not staff-driven. This requires that a staff remain small and not supersede the decisions, or work, that can be done by the members. Second, at the same time, networks do not "move" without some paid staff to co-ordinate, motivate, and carry the ball for busy people. The core staff needs to be compact, yet strong enough to maintain the momentum of the community.

Capacity

Capacity is the ability of an institution to translate thinking into action. For a lateral learning network, this involves developing effective and efficient mechanisms to improve members' technical skills and advance the field through training and technical assistance services, systems development and support, the creation of "best-practice" materials, and information dissemination. It requires the creation of an institutional structure and methodology of work that can support practical, state-of-the-art learning for practitioners.

Lesson 4. Focus on the Practitioner

The people who participate in SEEP's working groups should be doers, not theorizers. That includes experts in credit and savings, financial and institutional management, training, technology, marketing, and evaluation. Their conversations are grounded in field practice and free of institutional baggage. All exchanges are made with the spirit of cooperation, and open-mindedness is a common quality of every participant. All those involved in the work of the SEEP Network have to understand that they will give as much as they will receive from their participation in the network. Finally, they have to be infused with a spirit of humility, knowing that they can learn from many other organizations, even the smallest.

Lesson 5. One at a Time

Many networks or associations pursue so many goals that they are unable to reach any of them. We have learned that a good principle is to start with a single purpose and to build on it. In the SEEP Network, we started with a single purpose—to develop an evaluation system that captured the multiple dimensions of NGO enterprise programs. We then established the credibility of the network and built on it to increase the amount and importance of programs managed by the network. But in its first years, the SEEP Network largely devoted its limited resources to one major undertaking at a time.

Lesson 6. Mechanisms

We have to create mechanisms for learning that favor collective analysis and that include opportunities for all to teach as well as to learn. In the working groups, SEEP'S chief vehicle for learning, whatever topic a group is working on, the strength of the analysis lies in its focus on extracting what has worked in a variety of settings and methodologies and distilling that for others to learn from. At the same time, there is recognition that at any given time, there are some members with greater knowledge and experience than others.

Every network has to find a mechanism that will work for it and allow all members to share and learn from that mechanism.

Lesson 7. Products

Although a working group's efforts may begin with an internal exchange of information, the objective of a SEEP working group is to create a product of value to the larger community. The product may take the form of a publication or a training workshop. In both cases, the products focus on communicating new methods, systems, or state of the practice that are accessible and relevant to field implementers. The emphasis on products has helped considerably to focus the working groups in their work. Without having to develop such a final product, a working group might talk for years on a topic but never ever assemble and disseminate new knowledge for the benefit of the rest of the community.

We also have learned that to create a publishable product, it is usually necessary to have someone who is more committed than the others to champion the product, to put together the ideas and contributions of all other members of the working group, and to shape it into a final document.

The SEEP Network already has 23 publications that sell more than 1,500 copies annually.

Lesson 8. Grow Organically

The network has to start small and grow on success. For years, the first SEEP Network coordinator was a consultant. As various needs surfaced among members, the coordinator helped them define the needs and develop a specific strategy to address them. Then the SEEP network responded to these ideas and needs on a case-by-case basis, mobilizing members for the tasks at hand and hiring additional consultant help when absolutely necessary. The growth of the network is based mainly on members' resources. Even now, the network has only 2.5 full-time staff.

Lesson 9. Formalization

We have to establish the network as a formal institution only when needed. The results of the work of the network are far more important that the formalization process. For its first 10 years, SEEP was a project officially administered by a member of the network. That status has not prevented the network from growing and being recognized by international organizations and national organizations where it is involved.

Resources

Resources is the important capacity to mobilize resources for network activities and, in some instances, for members programs. In a field where self-sufficiency is much prized, networks are challenged to develop strategies that can lead to sustainability. Where the network does not serve as a microfinance channel, this involves developing a mix of resources, internal and external, to support its continuity.

Lesson 10. Frugality

The organization must keep core operations compact and expenses low. The network operations must depend heavily on substantial contributions from members. The SEEP Network's core budget is financed in three ways: by member dues, by funds generated from the sale of publications and from workshop fees, and by a grant from the U.S. Agency for International Development. Probably the most significant contribution of members is that they cover staff time and travel to board meetings and working group meetings. All SEEP members underwrite their travel and time associated with SEEP activities. The high level of volunteerism contributes to an esprit de corps of SEEP members that has been emblematic of the network since its inception and a defining part of its corporate culture.

The small budget of the core operations keeps the SEEP Network from investing too much in fundraising.

Lesson 11. Competition

The network should not engage in competition with members for program funds. This principle emerges from observation of other networks and consortia that have broken apart over resource issues. So the SEEP Network does not operate a credit program nor does it serve as a channel for subsidies to members.

Linkage

Linkage is the ability to build productive relationships with a wide variety of organizations. Linkages assist an institution in three areas:

- strengthening organizational capacity through access to information, technical assistance, staff training, and resources
- policy formation
- increasing legitimacy

For networks, the critical challenge is to expand the constituency for microenterprise through efforts aimed at information and advocacy, and through alliance building with key actors in the policy arena and the private sector.

Lesson 12. No politics

It is important to distinguish political activity from the research/learning agenda. It is easy to foster community and member commitment to a learning agenda, but it is much harder and risky to try to achieve a consensus among its membership around policy issues. Rather than invite divisiveness, SEEP has chosen to leave the advocacy role to other entities. This principle is rooted in the specific context in which SEEP operates, its limited resources, and its priority to foster professional development among its members. As a lateral learning network, and not a political representative body for its members, the SEEP Network focuses on a learning agenda.

Summing Up

In conclusion, these points can be stressed.

- Different networks are suited for different goals, and one kind of network should not be used to achieve every goal at the same time.
- A lateral learning network must be strongly oriented to its members and not oriented toward the structure itself.
- The network's results are much more important than its activities. The number of training workshops is far less important than the impact of those workshops on the growth of the members and their programs.
- To be sustainable, the network must have a sustainable budget and sustainable sources of funds.
- The leadership of the network must be, in the end, the people and organizations that understand the need to give as well as to receive while they participate in such a network.

For organizations considering the formation of some kind of network, there are six principles to keep in mind:

1. Each case is unique and needs a specific response to a specific environment and challenge.
2. Each network has to have a clear purpose; it has to rally members' interest.
3. Every solution has to be people-designed.
4. The network will have to evolve in a broader environment including donors, economies, and political systems.
5. Look for solutions that will last and respond to your present needs and the needs you will have 3 or 4 years from now.
6. Plan for change by starting to instill, in every participant, an attitude of support for the growth and development of the network and its members.

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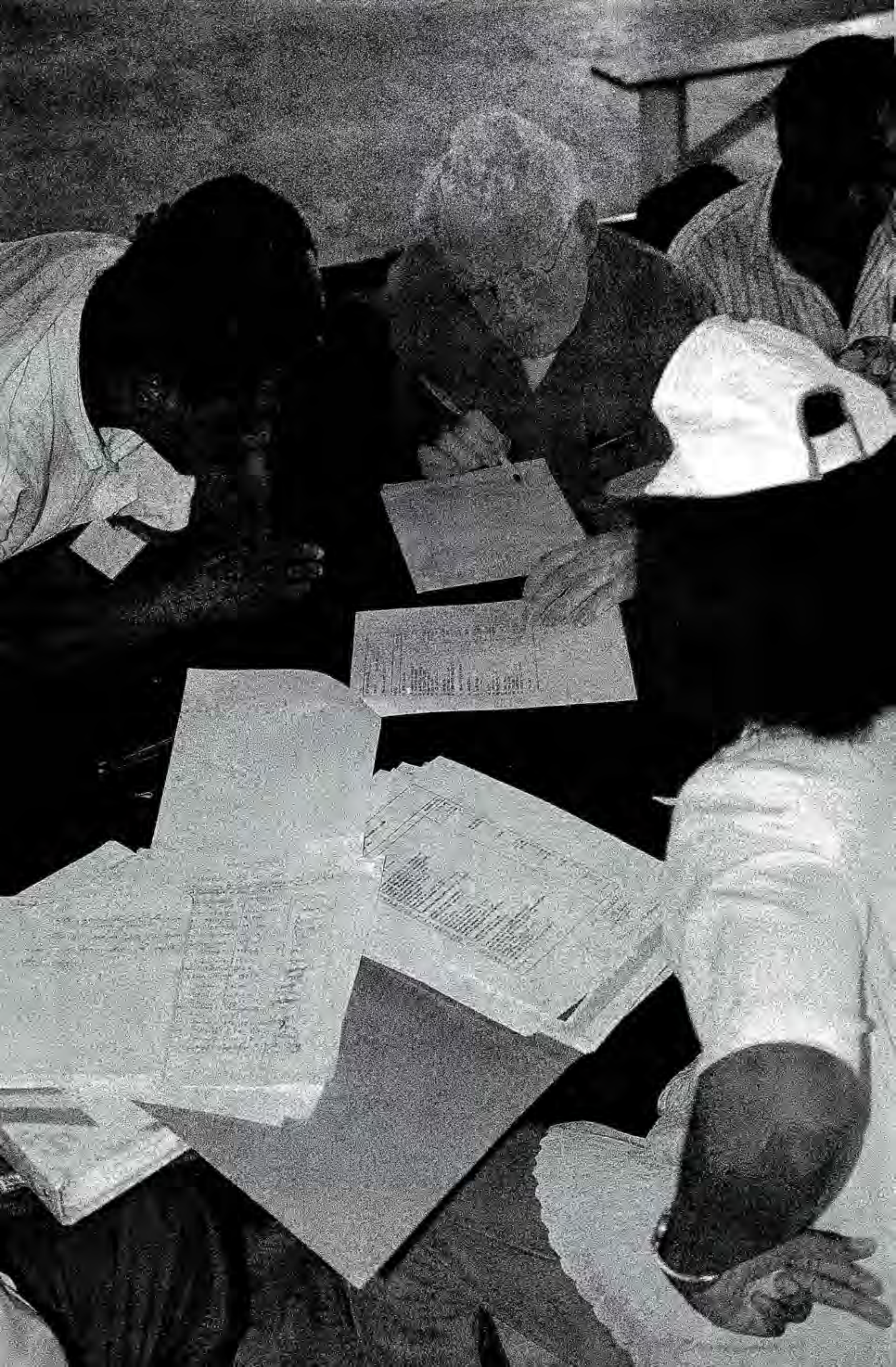
Part 2: Case Studies



BURKINA FASO

Le Projet de Promotion du Petit Crédit Rural

Julia Paxton

Le Projet de promotion du petit crédit rural (PPPCR) in rural Burkina Faso is attempting a difficult feat: to create a sustainable financial institution in a high-risk, low-income region. This relatively young institution, founded in 1988, has adopted a Grameen Bank-style model and each year continues to create context-specific innovations to overcome obstacles. Although repayment rates have been noteworthy, self-sustainability is still not in sight as PPPCR struggles with the high costs of providing credit to a widely dispersed, very poor clientele in a financially repressed country. The obstacles PPPCR has faced and the innovations it has developed provide insights for other institutions in similarly difficult milieus.

This case study examines the appropriateness of a Grameen Bank replication in Burkina Faso by describing its adaptation to the Sahelian context and analyzing three commonly touted advantages of group lending over other financial methodologies: that poor women prefer it, that repayment rates are better, and that costs are lower. The analysis raises new questions and sheds light on the innovations and obstacles of PPPCR as it struggles to become a sustainable financial institution for the poor.

Country Context

Burkina Faso is a landlocked country in West Africa and is one of the poorest countries in the world. Its GNP per capita in 1993 was only US$300 annually compared with US$520 for the sub-Saharan region (World Bank 1995). Because of the pegging of the CFA franc to the French franc, inflation averaged a mere 3.3 percent annually from 1980 to 1993. In 1994, due to the devaluation of the CFA franc,[1] inflation rates rose significantly to 30 percent that year. However, in 1995 and 1996, inflation came under control, averaging 5 percent at the end of 1995. From 1980 to 1993, Burkina Faso's 0.8 percent average annual growth in GNP per capita contrasts with –0.8 percent a year for sub-Saharan Africa. Real GDP growth in Burkina Faso has risen in the mid-1990s, averaging 4 percent in 1995.

Although commercial interest rates were positive in real terms from 1980 to 1993, the sudden change in economic conditions coinciding with the currency devaluation led to an erosion of positive real interest rates. Banking regulations capped commercial lending rates at a maximum of 29 percent annually. Meanwhile, inflation exceeded these ceilings in

[1] The average value of US$1.00 was CFAF 295 in 1993, CFAF 535 in 1994, and CFAF 477 in 1995.

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1994, causing the entire financial system to operate with negative real interest rates.

Another difficulty presented by the legal framework in Burkina Faso is the inflexibility of the laws pertaining to financial institutions. Financial institutions may be governed by the banking law, the credit union law (the 1994 *Loi portant réglementation des institutions mutualistes ou coopératives d'épargne et de crédit*, which applies to all countries of the West African Economic and Monetary Union) or by a convention with the Ministry of Finance. A microfinance NGO such as PPPCR can sign a convention with the Ministry of Finance, but this only gives the program official recognition without formal regulation and insurance. As PPPCR grows, its status becomes an increasingly important concern because it must determine the type of ownership structure, the financial products that it will offer, and its legal status.

Indeed, PPPCR is operating in one of the most difficult environments for microfinance. In particular, the program operates in villages where agriculture forms the heart of the economy with nonfarm activities including petty trade, services, and small industries. The country has been plagued with droughts that have the capability of destroying the economic livelihood of villages. Given these obstacles to financial intermediation, it is no wonder that numerous attempts to provide these regions with credit in the past have failed due to low repayment.[2] This failure is in part the result of politically motivated credit pushes with no emphasis on repayment, misguided targeting of economic activities, and inappropriate terms and conditions (Ellsasser and Diop 1990). The combination of low incomes, sparse population density, ethnic diversity, and susceptibility to shocks makes any type of microfinance activity particularly challenging.

Institutional History

Like the Grameen Bank, the foundation and direction of PPPCR have stemmed from a dynamic leader, Dr. Konrad Ellsasser. However, while Professor Yunus of the Grameen Bank is indigenous to Bangladesh, Dr. Ellsasser's efforts have been sponsored primarily by a French research organization, CIRAD.[3] In 1988, he was asked by CCCE,[4] the principal aid agency of the French government (since renamed CFD[5]), to prepare a development project for the drought-stricken area of Yatenga.

In 1988, after assessing that the drought-prone northern Yatenga region was credit constrained, 30 trial loans were granted in the villages of Banh and Ziga in the Northern province of Yatenga. One hundred percent of the loans were repaid in full, and thus CCCE contributed CFAF 3 million to start a full-scale lending operation with PPPCR as the operations branch for loan distribution under the auspices of the administrative unit Sahel Action. This unit collaborates with CNCA,[6] which is the principal agricultural development bank in Burkina Faso, and with the Burkina office of CIRAD. CFD provides interest-free lines of credit to the CNCA which, in turn, on-lends to PPPCR at 9 percent interest rate.

The PPPCR was created as an attempt to enhance financial security to some of the most disadvantaged people in drought-prone areas of Burkina Faso. The stated objective of PPPCR is to "study and implement financial products responding to the needs of a resource constrained clientele . . . and to create a system of financial intermediation at a low cost that is balanced and durable" (Faye and Bonkongou 1993). Operations are managed by a largely local personnel with one

French national as network director. CIRAD has played more of a support role rather than a management role, sponsoring several types of feasibility studies, offering training, and contributing to management information systems. The pilot committee of Sahel Action, overseeing management and internal control, comprises Sahel Action, the CNCA, CFD, and CIRAD.

Since 1988, PPPCR has expanded to the provinces of Tapoa, Ganzourgou, and Soum. In 1991, it began an urban and peri-urban expansion to include the women of the city of Ouahigouya. Since its inception, the program has served a population that is increasingly urban and semi-rural (rural areas with higher population densities). By 1995, 37 percent of the clients lived in urban areas, 29 percent lived in semi-rural areas, and 29 percent lived in isolated rural areas.

In the early 1990s, several issues reached the forefront as the experimental program matured into a financial institution. Dr. Ellsasser's vision had been to set up the program with foreign assistance, but to gradually lessen the external influence in favor of local control. As this transition evolved, the questions of staffing and the direction of the program surfaced. On the one hand, a field-savvy local staff had learned the logistics of program operation and favored the decentralized system of regional branches that had developed. On the other hand, new management (both foreign and local) was hired to lead the rapidly expanding program into its next phase of development. Centralization was encouraged as a form of internal control and unification. During this phase of development, different visions of institutional development occasionally clashed, leading to management turnover and a struggle to define the program mission.

Also during this phase, the legal status of the institution became an issue. As an NGO, PPPCR struggled with the high cost of servicing an isolated, low-income clientele. Given these costs and the availability of donor funds, certain advantages to remaining an NGO existed. Nevertheless, to become a true financial institution, the program needed to improve its profitability and to change its status from an NGO to a financial intermediary.

In 1995 and 1996, inroads into cost coverage were made and several institutional issues were resolved, leading to a new phase of institutional development. In a 1995 seminar, leaders reached the conclusion that PPPCR would remain an NGO for a transitory period. A jump to a legal status as a financial intermediary was deemed premature given the program evolution. In addition, a more harmonious working relationship was created as the staff agreed on the overall function and structure of the institution. Internal control was sharpened by the use of manuals describing a universal system of accounting, procedures, training, and standards for all four regional branches. Finally, specific objectives relating to financial self-sufficiency were introduced, giving the branches a common mission. The goals included raising the interest-rate margin through use of subsidized loans, increasing productivity through the use of new products and program expansion, lowering costs, and matching financial services to client demand (HORUS Banque et Finance 1996). The structure

[2] Prior credit programs have been implemented by Caisse nationale de crédit agricole and other governmental institutions.

[3] Centre international en recherche agronomique pour le développement.

[4] Caisse centrale de coopération économique.

[5] Caisse française de développement.

[6] Caisse nationale de crédit agricole.

and organization of PPPCR can be summarized as follows:

Number of credit agents: 52
Central office: Ouagadougou
Number of branches: 4
Number of loans (est.): 31,736
Legal status: NGO
Source of funds: 69% CNCA, 21% group funds and guarantee funds, 10% equity
Target group: Female, rural, poor
Methodology: Group lending (average group of 5)
Liability: No future loans until all members of group and sector have repaid

Adapting the Grameen Model to the Sahelian Context

Given prior failed attempts at providing rural credit in Burkina Faso, a different methodology was sought to ensure a higher rate of repayment. In 1988, the Grameen Bank was becoming widely known and group credit offered such an alternative. Specifically, group credit was seen as an opportunity to lower bank transaction costs in such an isolated area. Therefore, group credit was granted in the experimental phase and adopted formally by PPPCR given the initial high recovery rates.

Similarities to the Grameen Bank

Objectives, Strategy and Methods

The PPPCR parallels the Grameen Bank in several ways. Poverty alleviation through a group lending approach is a primary mandate for both institutions. Both the Grameen Bank and PPPCR target the poor excluded from the formal banking system by establishing credit facilities in the area of intervention. Average loan sizes are similar[7] and both institutions have mandatory savings.

Both the Grameen Bank and PPPCR can be classified as "credit-first strategies" (Graham and Von Pischke 1994) as opposed to "savings-first strategies." In the credit-first approach, outreach grows quickly because of the reliance on groups that can reach a wide number of clients and because external funds are used rather than relying on the time-consuming process of mobilizing local savings. However, a greater incentive to default occurs in the credit-first programs since members know that they are defaulting on external funds rather than the savings of their neighbors, although more empirical research in this area is needed.

In addition, the belief that group solidarity and peer pressure contribute to loan repayment and act as a collateral substitute exists in both programs. The PPPCR also has emulated the Grameen credit group of five members in most groups, although some groups range from three to six members. Groups of five were found to perform best in Burkina Faso because (1) *tontines*[8] are often based on five members (2) a base-five counting method is common in some areas, and (3) groups of five were large enough to reduce bank transaction costs while small enough to preserve unity and solidarity within the group leading to favorable repayment rates. Also, like the Grameen Bank, PPPCR has a participatory managerial style that allows for a flow of information from village agents to bank managers. Once a week, all the village agents meet with the province manager to discuss weekly issues and ideas.

Female Clientele

Finally, both PPPCR and the Grameen Bank direct a large portion of the loan portfolio to strictly female groups. The PPPCR has continually increased its share of loans to women so that it currently lends almost exclusively to females. Ninety-eight percent of PPPCR's clients[9] are women. The initial objective of the project was to target the most disadvantaged people in Burkina Faso, of whom

Table 1. Evolution of the PPPCR loan portfolio.

Year	Exchange rate (CFAF/US$)	Loans granted No.	Loans granted Volume (CFAF millions)	Average loan CFAF	Average loan US$	Loan balance (CFAF millions) At year end	Loan balance (CFAF millions) Arrears	Arrears rate (%)
1992	275	3,890	98	24,430	92	47.9	5.2	10.2
1993	295	6,758	131	19,478	69	95.2	4.2	3.2
1994	535	14,270	352	24,680	44	262.6	6.4	1.8
1995	477	25,000	835	29,613	59	600	14	2.3

Source: PPPCR internal audit 1996.

women are the majority. After the drought of 1984, the role of women as contributors to household income became more pronounced as off-farm income became increasingly important. In addition, several village agents reported that women clients required less of the agents' time than men since they accepted the rules and regulations of the project more readily, without time-consuming questions and arguments with project personnel. Therefore, some bank employees believed that working with women would lead to lower bank transaction costs.

Another logical reason for providing women with credit is that migration of Burkinabé men to neighboring Ghana and Côte d'Ivoire is a pronounced phenomenon. In fact, in bad harvest years, male labor is Burkina Faso's primary export (Economist Intelligence Unit 1988). Burkinabé women, who traditionally perform most of the agricultural and household duties, as well as engaging in commercial activities, are assuming even more responsibilities as more men leave (Savané 1986).

Differences from the Grameen Bank

Outreach

The PPPCR is not a pure Grameen replication and indeed has numerous departures from the Grameen model. One of the most striking differences is size. The Grameen Bank was started in 1983 and has quickly grown to be one of the largest microfinance programs in the world, serving over 2 million clients by 1995. This rapid expansion was facilitated by the high population density in Bangladesh.

Like the Grameen Bank, PPPCR has grown quickly, but cannot compare in number of clients. By the end of 1994, PPPCR had served 10,000 clients, and 2 years later it had reached about 25,000 clients. Table 1 illustrates the rapid growth in the number and volume of loans from 1992 to 1995. In October 1995, it was projected that by year's end, the cumulative number of credits, including repeat borrowers, would reach 51,270 loans.[10] The associated cumulative amount of credit totals US$2.35 million. In 1995 alone, 25,000 micro-loans were made with an average loan size of US$59. These loans are only 20 percent of the GNP per capita, a clear signal that PPPCR is reaching a marginalized clientele. This ratio is well below the average, 35 percent, measured for microfinance institutions in West Africa as a whole (Paxton 1996a). It should be noted that while the loan sizes are steadily increasing in CFA francs, their dollar value has been lower because of the 1994 devaluation.

[7] Average loans sizes ranged from US$44 to US$92 for the PPPCR from 1992 to 1995 while the General Loan of the Grameen Bank averages US$75 to US$100. In 1993, Burkina Faso had a GNP per capita of US$300 in comparison to US$220 for Bangladesh.

[8] A tontine is the term used in Burkina Faso for an informal group known as a ROSCA (rotating savings and credit association).

[9] 10,000 cumulative clients served were recorded in 1995.

[10] Jacques Marzin, "Responsable du Service Réseau," personal communication, October 17, 1995. Since two 6-month loan cycles can be obtained in 1 year, the number of credits is roughly double the number of clients.

Management of a Sparsely Populated Area

Some of the modifications of the Grameen model have resulted from the particular context of Burkina Faso. PPPCR's smaller scale of operations is a function of the smaller population and sparse population density. In contrast to Bangladesh's population density of over 800 people per square kilometer, Burkina Faso has only 40 people per square kilometer. In an attempt to lessen the high transaction costs arising from a dispersed population and the remoteness of certain villages, a hierarchical style of bank management was implemented. Villages are divided into *quartiers* (neighborhoods) and then subdivided into groups of five, with group leaders, quartier leaders, and village committee leaders. As in the Grameen Bank, the formation of groups relies on the assumed effectiveness of peer pressure and group solidarity. This feature is particularly important in the African setting since each village agent collects weekly repayments from 200 to 800 clients, making evaluation and monitoring of each client difficult. In addition to using joint liability as a collateral substitute, PPPCR also uses sectoral liability. In this case, no group in an entire village can receive new loans if another group has defaulted.

Adaptation to Clients

Even though both the Grameen Bank and PPPCR work with many illiterate clients, the problem of illiteracy is even more pronounced for PPPCR. The 1990 adult female illiteracy rate in Burkina Faso was 91 percent, though rural rates were even higher, compared with 78 percent in Bangladesh (World Bank 1995). Traditional formal banks operating in Burkina Faso have required literacy so that the clients can complete applications and documents. However, in rural regions, nearly all women over the age of 40 are illiterate. As a compensation for the lack of written communication, many rural African areas have an impressive oral tradition. The PPPCR incorporates this tradition by verbally explaining the terms and conditions of the loans in an open town meeting. The village leaders are intimately involved in the loan process as monitors, evaluators, and motivational leaders.

While the absence of written guidelines for the clients is a logical step given the rural context, it presents certain risks. For example, the interpretation of the rules and regulations may vary across village agents. This problem has been lessened by a 1-year training period for all new village agents.

A unique feature of the PPPCR clientele is that they belong to a multitude of ethnicities with the major ones being Mossi, Rimaibe, and Peulh. Numerous languages are spoken by the clients and few of the clients in isolated rural regions speak French. Therefore, bank officers must be multi-lingual in order to provide financial services to each ethnic group. This presents interesting and complex relationships between bank agents of one ethnicity serving clients of another ethnicity. However, bank agents report that this does not affect loan repayment significantly.

Types of Credit

Perhaps the most outstanding characteristic of PPPCR has been its ability to evolve and adapt to different settings through various financial innovations. The Grameen model was not merely artificially transplanted into the African setting, but each characteristic was tested for its feasibility in Burkina Faso. During the experimental phase, different group sizes, loan sizes, loan types, and terms and conditions were appraised. Group loans versus individual loans to both men and women were tested in different regions of the country. In addition, loans targeted for specific occupations were examined as well as loans with no explicit stipulations on how they would be used.

As previously mentioned, the project determined that it was most advantageous to work with women in groups of five. While small credit groups are organized, the loans are recorded individually and no true joint liability exists. Although the women are told that each is responsible for the entire repayment of the group loan, in practice, if one member does not repay, the others in the group are blocked from future loans. No strict guidelines exist regarding how the loans should be used. Although loans are targeted for profitable economic activities according to the guidelines of PPPCR, in practice, much of the credit evaluation is left to the discretion of the sector leader. This relaxed approach to project evaluation on the part of the project coincides with the concept of the fungibility of money (Von Pischke and Adams 1983). Since money received from a loan is identical to money obtained from other sources, it is difficult to determine the final destination of any given loan amount, regardless of what is promised at the credit screening session.

Many innovations have emerged from PPPCR in the form of loan types adapted to local activities. The most common type of credit given resembles Grameen style loans. These loans are made for small market activity, have a 1-year term, and are granted to a group of five in which weekly repayments are made. Weekly repayment corresponds to the regular and modest revenue generated by market women. For a loan of CFAF 20,000, CFAF 1,000 is paid to a group fund as obligatory savings to be returned at the end of the loan or used as an emergency fund, CFAF 400 to a guarantee fund, and CFAF 2,000 for interest payments (10% of the initial loan size). Repayment is collected weekly for 56 weeks, resulting in an annual effective interest rate of 26 percent including the effect of contributing to the funds. During the past 5 years, this effective rate has mostly been positive . The frequency of installments allows women to repay their loans without holding the money at home where it is at risk of being used by family members. The village or sector leader is in charge of collecting repayment from all members and the repayment is double checked and recorded by the loan officer and brought directly to PPPCR for entry into the computer data base. These working capital loans have been granted for artisan activities, food production, soap production, and sales of food products and cigarettes. Typically, the ethnic caste of the borrower determines which types of economic activities are acceptable for the borrower to pursue. However, with the introduction of credit, these rigid cultural norms are changing slowly (Ellsasser 1989).

A second credit line has been introduced for the fattening of animals for resale. These group loans typically span a 5- to 6-month period and have only one repayment at the end of the period when the animal is sold. These loans are small, ranging from US$10 to $150 in 1995, in order to purchase small livestock. This type of loan frequently has been offered to men and women of different ethnic groups. Monitoring this type of loan has proven difficult since tracking the health and sale of an individual animal is laborious.

Another type of loan has been designed for clients to buy grain during the harvest period when the price is low and then to consume it or to sell it during the off season. These loan sizes are larger, reaching up to US$300 for a group of five. This has proven profitable for the clients and has reduced the need for grain intermediaries who had previously engaged in similar types of speculation.

Not only has PPPCR adapted its loan instruments to the local context, but it has also been innovative in its research. Each year, students from France and other parts of Africa have come to perform studies on various aspects of the project. Three Burkinabé students have written their theses on various aspects of PPPCR. The studies include economic and agronomic studies, as well as the feasibility of new economic activities that could be financed by PPPCR. The PPPCR continues to experiment with loan instruments tailored to specific economic activities. Ongoing research by student interns ascertains the feasibility of credit for exports, weaving, the cultivation of onions, potatoes, rice, and vegetables, and the purchase of farm implements. Each type of new credit is designed with terms and repayment schedules that match the cash-flow patterns of the activity.

Absence of Voluntary Savings

It has been demonstrated in many developing countries that one of the keys to financial development is providing deposit facilities for the poor. The ability and willingness of low-income people to save is often underestimated and constitutes the "forgotten half of rural finance" (Vogel 1984). Like the Grameen Bank, PPPCR has a compulsory noninterest-bearing savings program generated through its group fund. At the granting of each loan, the clients contribute to a common fund, which can take the form of a group or village fund, depending on the region. However, there has been much confusion on the part of the clients regarding this fund. Sometimes the entire village fund has been used to cover the arrears of a few groups and has not been returned at the end of the loan. Furthermore, there exists confusion between the role of a savings fund versus an insurance fund. A clearer understanding of the function and proper administration of compulsory savings is vital to the trust between the institution and the clients.

While the amount of voluntary savings is growing in the Grameen Bank, there has been little emphasis on this service in PPPCR. At one point, voluntary savings were collected, but returned to the clients when new personnel implemented program changes. This violation of trust and instability will make future savings mobilization more difficult.

One of the main reasons that savings have not been stressed in PPPCR relates to cost. There is little interest among bank workers to collect savings since it adds to the responsibilities of each village agent. Even at the managerial level, savings are perceived as a highly labor intensive, low profit activity. In fact, the nature of small daily transactions, often on the order of pennies and nickels, can lead to the conclusion that savings mobilization is indeed an expensive financial service. Although there is no question about the benefits of savings facilities among clients, the financial viability of small savings mobilization in the African setting is an area requiring more research. Certainly West African credit unions have had considerable success in mobilizing small deposit amounts in both rural and urban settings. Given the benefits of savings mobilization, the introduction of voluntary savings remains one of PPPCR's future goals. To do so in a cost effective manner will require additional experimentation, research, and financial innovations.

Social Agenda

Unlike the Grameen Bank, PPPCR does not play a pro-active role in altering the social norms of its clients. To receive financial services, the Grameen Bank clients must adhere to a set of rules described in the "16 Decisions." These rules outline acceptable social behavior including the refusal of dowry payment, the promotion of education, and health practices. In addition, the use of social rituals at group meetings such as chanting and saluting fosters group identification and discipline. The PPPCR has not incorporated any such social agenda, instead focusing solely on the provision of financial services.

Appropriateness of the Group Lending Approach

To build a healthy and sustainable financial institution, it is important to consider the possible advantages and disadvantages associated with different methodologies. There are several justifications for group lending cited in the literature. Repayment rates might be higher through reliance on the group pressure, solidarity, screening, monitoring, and information advantages of the group. In addition, outreach could be deeper because some clients might be more inclined to join a group of their colleagues than to go to a financial institution with which they have had no prior contact. If the groups function well, then they might be used, in addition, for nonfinancial activities related to education, health, and other social services. Finally, institutions may engage in group lending to reduce transaction costs by serving a large number of clients with only a few loan officers.

Additional research in each of these areas is required before any conclusions about individual versus group lending can be drawn. In addition, cost, repayment, and client attitudes about working in groups are interrelated. For instance, as an institution spends more on evaluation, group training, group formation, and monitoring, its repayment rates will be affected. Likewise, clients that are resistant to group formation could increase formation costs or affect repayment rates.

Are Repayment Rates Lower Due to Group Lending?

Since PPPCR utilizes group lending only, it is not possible to compare the repayment records of group versus individual lending within PPPCR itself. Nevertheless, some interesting repayment patterns exist in PPPCR. In particular, three major types of group dynamics were witnessed, including the domino effect, group solidarity, and peer pressure. These were some of the concepts included in a recent study on the determinants of repayment behavior of PPPCR clients.

The Domino Effect

The PPPCR has adapted itself to the sparse population by creating a hierarchical structure in which one village agent works with several hundred clients, relying on group and sectoral organization to reduce transaction costs. The sector or village, composed of approximately 30 groups, is denied access to future loans until each of the groups reimburse their full loan amount. However, this type of sectoral liability has led to a domino effect in which it is in the best interest of any group to default as soon as another group defaults. Thus, sectors either repay in full or have widespread default. The domino effect can occur at either the group level (where individual group members intentionally default since other members of their group have defaulted) or the sector level if sectoral liability exists. This phenomenon has been expressed both theoretically and empirically (Bratton 1986; Besley and Coate 1991).

Besley demonstrates an inherent instability of group lending in his formulation of the "repayment game." In the game, the use of social sanctions can lead to increased repayment rates since they can encourage a delinquent borrower to repay when the individual may have chosen to default under individual lending. However, in other cases, if one individual is determined not to repay, then group members may either repay for that person or decide to default themselves, leading to a domino effect of default. As long as the groups function smoothly, the group lending technology has the capability of recovering a higher percentage of loans. However, if problems arise in the groups, widespread default can occur. These findings have been witnessed empirically as well. Bratton found that in Zimbabwe, group lending operations had higher repayment rates in good years than individual lending programs. However, in bad years, the findings were reversed, due to the domino effect.

The domino effect can be initiated by any type of repayment problem. In Burkina Faso, the village of Banh experienced a swift increase in arrears after the 1990 drought. The high degree of covariant income in a predominantly agrarian society is another factor that threatens the financial institution viability in the Sahel. In more urban, highly populated areas, the variety of economic activities allows for healthier portfolio diversification and some protection from the economic impact of droughts. In a more urban sector that experienced widespread default, rumors of unethical behavior led the entire sector to collapse. In any sector, the first group may default for any number of reasons, but once this occurs, the whole sector tends to collapse. In the words of PPPCR founder Konrad Ellsasser, the success of group lending can be likened to an airplane. It relies on many different parts, all of which could have any number of technical difficulties. If even one part fails, the plane cannot fly.

Group Solidarity

Group solidarity, defined as the willingness of the credit group to pay for one of its members on occasion, functioned well within most of the small groups studied in Burkina Faso where the bond of trust, loyalty, friendship and respect was well developed and truly functional. However, once a member was unable to repay four or five of her weekly repayments, the entire group went into default. Interestingly, the group was the main source of funds that the women relied on in the face of adversity. They rarely borrowed from their husbands, families or other friends in bad times. A comparable degree of solidarity was not present at the sector level. Part of this phenomenon can be explained by the fact that individuals do not interact and monitor other groups to the extent that they can within their own group. In addition, the dilemma of collective action is present as individuals can engage in "free-riding" by relying on the rest of the sector to enforce the repayment of other groups. Hence it is not surprising to see the domino effect in some groups of PPPCR.

Peer Pressure

Group pressure is exhibited in two ways. Firstly, ex ante pressure is the threat of peer pressure that would manifest if one member of the group did not repay. This type of pressure exists in correct paying groups and acts as a deterrent, whether or not the threat is real or imagined. Ex post pressure is defined as the social sanctions incurred by a group member who defaults on the group loan. These sanctions can range from negative comments to exclusion from social events to more severe types of punishment such as the forced sale of household items.

Results from the PPPCR client survey indicate that ex ante pressure contributed to correct repayment, but the presence of ex post pressure was not widespread. Usually, the reasons given for default were of an uncontrollable nature (such as an illness or unexpected family expense). Since the women did not default as a result of their own laziness or misbehavior, it can be deduced that a degree of ex ante pressure existed. Given the legitimate reasons for default, the other group members were uninterested in applying ex post pressure. Even in cases where the reason for default was perceived as controllable, little ex post pressure was applied in an attempt to maintain village harmony. As one neighborhood member explained, 'We may sometimes feel angry, but we will never pressure other members so as not to ruin the neighborhood peace.

One cultural dynamic that has impacted the viability of PPPCR has been the hierarchical societal structure in Burkina Faso. An individual's position in society is largely determined at birth by his or her ethnic group and family. Furthermore, there is an overwhelming respect for the elderly. In a polygamous society, it is the first, and usually oldest, wife who has the most power among wives. This respect led to advantages and disadvantages for the functioning group dynamics.

On the one hand, the hierarchical structure allowed PPPCR to establish respected village leaders as project monitors in an expedient fashion. The village chief had detailed knowledge of the creditworthiness of each member of the village and this facilitated loan allocation. On the other hand, when individuals were divided into groups, there was a sense of moral obligation to include the most elderly women to join if they so desired. Often these women no longer engaged in economic activities and were unable to repay their loans. However, because of their privileged societal position, it was difficult for other members to pressure them to pay.

Results of Repayment Study

The determinants of successful repayment were analyzed by Paxton (1996b), based on data collected from 150 credit groups. Econometric results suggest that several variables are significant in predicting correct repayment in groups while other variables tended to destabilize the repayment process. Urban market women were much more proficient in managing credit group responsibilities. First, they were familiar with group activity since indigenous ROSCAs and other social organizations are divided into groups. Second, their previous participation in informal financial activities allowed them to understand the role and importance of financial services. Some market women were so sophisticated that they independently organized a ROSCA with their PPPCR credit group to act as a contingency fund for an occasional inability to pay their weekly repayment. Finally, the degree of monetization in the urban setting and the clients' daily cash-flow operations made the urban market women relatively sophisticated clientele familiar with the requirements of borrowing.

Another important variable in predicting repayment was the group's exposure to training and leadership. In the rural village of Madougou where repayment was 100 percent, the bank agent worked closely with the village committee and carefully established lending rules as well as how groups should function. The village committee played a large role in educating the entire village on how the groups should react if one member was unable to repay on a given day. Each group interviewed in Madougou had contingency plans to repay in case of sickness, travel, or other reasons. This type of planning was not evident in Banh, a village characterized by widespread default.

The variable measuring the number of other informal credit contracts that an individual had was a significantly positive determinant of loan repayment. This supports the hypothesis that having other contracts is an indication of creditworthiness rather than having obligations spread too thin. Typically, the other contracts would be informal loans from family members. Viganó (1993) reported the same finding in Burkina Faso.

Two primary destabilizing factors led to decreases in the repayment rates. One reason why group lending may not lead to the highest repayment rates can be referred to as the "matching problem." All five members of the group receive similar loan amounts for a term of 56 weeks (in most cases). At the first meeting, the bank loan officer invites all those interested in receiving such a loan to the meeting. Individuals divide into groups through self-selection. Once the first loan cycle is over, the group can qualify for a second, larger loan. The odds that each group member will want an additional loan at the same time once again is much lower than at the original meeting. If four of the five want a new loan, the fifth member may go along with the group if she is indifferent. As more indifferent people are carried along with the process, the problem of arrears is exacerbated as individual needs are not matched to the loan sizes and terms. Higher arrears rates were found in groups that had gone through several loan cycles and the variable "loan cycle" was found to be negatively related to repayment.

Finally, a latent variable measuring the domino effect (both at the group level, measuring the number of members with repayment problems, and at the sectoral level, measuring whether or not groups in the sector had defaulted on their loans) was found to be a negative determinant of repayment. Regardless of the group dynamics, leadership and training of the groups, income, and other factors, if too many people in a group or sector defaulted, the entire group/sector tended to default as the incentive structure for repaying was altered. This variable was statistically significant and points to one of the most destabilizing effects of joint liability.

The traditional assumptions about group lending are that group pressure and solidarity lead to high repayment. However, in Burkina Faso, ex post group pressure is not a commonly used tool for societal reasons. Although group solidarity was employed, its use may be outweighed by the domino effect and there have been no studies to indicate whether or not solidarity may also function in an indirect way for individual lending. The real danger for group lending in Burkina Faso is not that people will not try to help each other, but that covariant shocks affect more than one individual or group at a time, thus resulting in sectoral collapse.

Do the Clients Prefer to Work in Groups?

An underlying justification for group lending often given is that poor people prefer to participate in groups for financial services. The central idea behind this belief is that poor people would feel more comfortable dealing with an institution if they were among friends and that weekly meetings would encourage hard work, camaraderie, and repayment. In addition, group formation facilitates the implementation of social services, although this is not relevant to PPPCR, which is strictly a financial service institution.

The empirical evidence from Burkina Faso suggests another story. The transaction costs of participating in a group are high. Each week the members of the group must coordinate schedules and bring their repayment to a group meeting. The group leader, in turn, must meet with the sectoral leader each week and be accountable for each member of her group. The sectoral leader is unpaid, yet is responsible for meeting with the group leaders and for the safekeeping of the funds for 10 to 30 groups.

From a social perspective, the clients always live in the same small village or quartier, and if they want to see each other socially, there is nothing preventing them from ad hoc social meetings. When asked if they prefer to work together as a credit group, nearly all of the women surveyed responded that individual loans are preferable to avoid any sectoral animosity when arrears occur. A perception of injustice arose when one group defaulted and the others were punished. In addition, given the social hierarchy where some women, due to youth or ethnicity, felt uncomfortable pressuring other women, the use of peer pressure was not effective.

Does PPPCR Lower Its Costs by Group Lending?

Regardless of the personal preferences of the clients, a legitimate justification for group lending from the institutional perspective is that it lowers institutional transaction costs. Adams and Romero (1981) found borrower and lender transaction costs to be lower under group lending because of less paperwork, lower fees, and fewer visits. The hierarchical structure of PPPCR lends itself to reaching a large number of clients per loan officer. Indeed, the employees of PPPCR see the use of groups as the only way to reach a large number of clients. If individual loans were given, it would be impossible for a single loan officer to serve 400 to 500 clients a week. Some of the critics question assumptions that transaction costs are indeed lower to borrowers and lenders under group lending. The time commitments of group members is enormous and group mobilization and training cause high program costs (Huppi and Feder 1990; Khandker, Khalily, and Khan 1994).

For PPPCR, it is clear that clients dedicate a great deal of time each week to the repayment of the loan even though fees and bureaucracy are at a minimum. On the institutional side, training, personnel, and group mobilization are indeed high costs. Table 2 illustrates that interest income is well below operating costs. In fact, costs have consistently exceeded earlier projections. Factors contributing to the high costs include (1)

Table 2. PPPCR efficiency indicators 1993–95.

Year	Interest income (CFAF millions)	Operating costs (CFAF millions)	Interest income vs. operating costs (%)	Operating cost/CFAF 100 lent	Growth (%): Number of loans	Growth (%): Outstanding loan volume	Growth (%): Project costs	Per loan officer: Outstanding loan balance (CFAF millions)	Per loan officer: Loans (no.)
1993	17.5	117.7	14.8	90	74	99	–	5.3	375
1994	40.2	188.2	21.4	53	111	176	60	9.7	529
1995	86.4	200.3	43.1	24	75	128	6	18	860

Source: PPPCR internal audit 1996; Horus Banque et Finance (1996).

significant start-up costs and technical assistance, (2) pressure from donors to expand rapidly, (3) the creation of a central office in the capital, (4) the demand for relatively high salaries, and (5) the relatively low population density and the isolation of some clients.[11]

Although high program costs have proven to be an obstacle for PPPCR, some progress has been made toward improving overall institutional efficiency. Table 2 shows that costs are not growing as fast as the loan portfolio and a strong favorable trend exists for efficiency indicators. Program administrators believe that the group technology indeed lowers its costs, and if the project were to convert to individual lending, costs would soar. In fact, the lowering of costs is the primary justification for the group lending methodology used by the creators and managers of PPPCR. However, no study has been able to document the cost advantages of either group or individual lending in the Sahelian context, although such a study would be quite revealing.

Upon further analysis, it appears that it is not the use of groups, per se, that contributes to lower institutional costs, but the use of a hierarchy so that each loan officer only has to visit a few key contacts to collect the repayment. Therefore, it is possible to envision a similar hierarchical structure as is present in PPPCR with individual, rather than group, loans where group and sectoral leaders would be paid incentives to collect repayment from members, but no joint liability would exist. This system may have several advantages. It maintains the low transaction costs of group lending. It frees individuals from joint liability, which can lead to the domino effect and neighborhood discord. And it solves the matching problem, allowing individuals to apply for loans as they are needed rather than when the group needs one. Experimentation would be necessary to determine if such a system would be viable.

Conclusions

The PPPCR has been particularly innovative in adapting a Grameen style of group lending to the conditions in West Africa. Certainly the Sahelian region represents one of the most challenging environments for microfinance due to the combination of failed previous efforts, low population density, poverty, and illiteracy. To overcome some of these obstacles, PPPCR has departed from a pure Grameen replication and has adapted its financial services and organization. The experience of PPPCR underscores the importance of a thorough understanding of the regional context before replication of any type of microfinance model is attempted.

The primary justification for the group lending methodology given by PPPCR is that it reduces costs through the use of a hierarchical structure. In addition, the mechanisms of peer pressure and group solidarity have led to favorable repayment rates. Although group dynamics have been successful in most groups, in some villages, they have led to a domino effect of widespread default, highlighting a potential source of instability in the future. The clients have accepted the group structure of the project, but report that they would prefer individual liability because of the strain that joint liability imposes on the groups and the village.

Despite all of the careful modifications of the Grameen model to the Burkina Faso context, the provision of microfinancial services has proven to be quite costly in the Sahel. The reasons for these high costs

[11] The northern region of Burkina Faso has a 1991 population density of 14/km² compared with 810/km² in Bangladesh.

are more related to the environment (low population density, poor infrastructure, poverty, illiteracy) than to the methodology of group lending itself. The use of a hierarchical group lending structure has allowed one loan officer to serve a large number of clients. A greater awareness of group dynamics will allow the program to fine tune its organization and training of groups. In addition, the future viability of the program is linked to the legal environment of Burkina Faso that dictates institutional forms, interest rate ceilings and deposit insurance. The PPPCR has experienced greater efficiency in the past couple of years as it continues to learn from its early experience and achieves economies of scale. The extent to which this improvement can continue will determine whether or not this approach will become viable and sustainable in the future.

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MALI

Self-Managed Village Savings and Loan Banks in the Pays Dogon Region

Cécile Fruman

The self-managed village savings and loan banks known as CVECAs[1] constitute one of the first African microfinance networks to succeed in formalizing its operations, having graduated from project status and a dependency on donor and government support. It is now a private network that is close to reaching financial self-sufficiency. The network's self-reliance can be attributed to two factors: a gradual withdrawal of external support and a concomitant transfer of responsibilities to local actors. This transfer has served to strengthen ownership of the network on the part of its members.

The network has succeeded, under very difficult circumstances, in offering quality financial services to a population excluded from formal financial systems, and it is now approaching technical and financial self-sufficiency. The challenge facing the network today lies in its capacity to reconcile the requirements of professional banking—necessary to manage a steadily increasing financial volume—with the desire to minimize operating costs in order to achieve and maintain financial sustainability.

Country Context

Mali is one of the world's poorest countries, with a per capita GNP of US$250 in 1995. The area of the country is some 1.2 million square kilometers, but only one-quarter of the land is arable and that area must sustain 74 percent of the nation's largely rural population. The real rate of growth in GDP was 2.6 percent in 1994 and 6 percent in 1995. Structural adjustment policies, the devaluation of the CFA franc in January 1994, and the return to democracy in 1991 are some of the main factors driving this economic growth.

The Malian formal banking system comprises six commercial banks and two nonbank financial institutions. The government holds a major portion of equity in these banks. The liquidity of the banking sector remains high because commercial banks are reluctant to grant loans to local businesses. The information they obtain on such businesses is generally inadequate and, because the judicial system is unreliable, it is difficult to enforce contracts. As a result, commercial banks invest a large share of their resources in the regional money market. BNDA,[2] the national agricultural development bank, is the sole institution that finances rural activities and provides support for microfinance networks.

Informal finance mechanisms have long existed in Mali. In urban areas, men and women—mostly those that are active in trade—participate in rotating savings and credit associations, also known as

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tontines. In rural areas, traditional self-help organizations such as women's groups or neighborhood groups engage in a variety of income-generating activities such as sowing a common field or transporting the harvest for others. The income generated is used in part to give loans to members of the group, often with very low repayment rates because of lax rules and frequent debt forgiveness.

The more formal microfinance sector in Mali is still young: the CVECAs in Pays Dogon in Eastern Mali and Kafo Jiginew in the cotton-producing area of southern Mali are the oldest institutions, and they were created scarcely 10 years ago. In 1996, membership in these two networks amounted to 21,500 and 45,000, respectively, i.e., 42 percent of all individuals accessing the services of a microfinance institution in Mali. The formal microfinance sector has experienced significant growth during the 1990s: roughly 20 networks have been set up in both rural and urban areas. On December 31, 1996, these systems served 160,000 clients, held more than CFAF 5 billion (US$11 million) in savings, had CFAF 5.8 billion (US$11.6 million) in outstanding loans, and employed 322 persons (World Bank/GTZ 1997).[3]

The microfinance institutions in the West African Economic and Monetary Union (UEMOA[4]) are regulated by a law governing mutual and cooperative savings and credit institutions, known as the PARMEC law,[5] which was developed by BCEAO,[6] the West African Central Bank, and voted into law in Mali in 1994. This law pertains specifically to networks of mutual and cooperative institutions, but also governs all other forms of microfinance institutions. Noncooperative institutions must sign a 5-year agreement with the Ministry of Finance that entitles them to conduct business and places them under government control.

The standard agreement adopted by the UEMOA Council of Ministers is succinct and does not stipulate methods of supervision. Furthermore, given the "negotiable" nature of the agreement, institutions are more dependent on the good will of the Ministry of Finance than on the actual provisions of the law. The network of CVECAs in the Pays Dogon region has recently submitted to the Malian minister of finance a detailed draft agreement with eight annexes. The network will also need to negotiate a waiver on acceptable annual interest rates since the PARMEC law in 1997 set usury rates at 18 percent for commercial banks and 30 percent for microfinance institutions. Although this does represent progress in comparison to the definition previously used (twice the discount rate of the Central Bank, i.e., a usury rate of about 13 percent in 1996), this cap on interest rates could hinder efforts to achieve financial autonomy for many microfinance institutions, including the CVECAs of the Pays Dogon region.

The CVECA Network in Pays Dogon and Expansion to Other Regions

The CVECA Concept

The concept of self-managed village savings and loan banks, or CVECAs, was developed by CIDR,[7] a French NGO that specializes in development projects of an economic or financial nature. The

[1] Caisses villageoises d'épargne et de crédit autogérées.

[2] Banque nationale de développement agricole.

[3] In December 1996, US$1 = CFAF 540.

[4] Union économique et monétaire ouest-africaine.

[5] The real name of this law is "loi portant réglementation des institutions mutualistes ou coopératives d'épargne et de crédit." It is commonly referred to as "loi PARMEC" because of the name of the BCEAO program that designed it.

[6] Banque centrale des Etats de l'Afrique de l'Ouest.

[7] Centre international de développement et de recherche

CVECAs were designed to serve as a financial instrument for villages, specifically by playing a key role in the self-development and self-organization of village populations. The underlying tenet is that villagers can become less dependent on outside assistance and less vulnerable to climatic and economic contingencies by learning to rely more heavily on their savings capacity and their own management skills.

Throughout the process of creating networks of CVECAs, CIDR plays the role of catalyst. It provides support in the form of training, bank monitoring, and the transfer of expertise, but it plays no role in financial intermediation. Over a period of approximately 10 years, CIDR accompanies networks through the various stages of creation, consolidation, and formalization. CIDR's objective is to help the CVECA networks reach maturity and become sustainable. All network actors are prepared for the withdrawal of technical and financial assistance many years in advance.

History of the CVECAs in Pays Dogon and Regional Characteristics

The CVECA concept was first tested in Burkina Faso in 1983, in the northern region of Oudalan. Although some 20 CVECAs were set up, the experiment was incomplete because the CIDR project ended before the goal of creating an autonomous network was achieved. In 1984, a study was carried out in the Sahelian region to identify an area where the CVECA concept could be tested over a longer period and with greater resources. In 1985, a subsequent feasibility study selected the Pays Dogon region because of a climate of openness in Mali and a favorable working environment for NGOs; the strong social cohesion and solidarity within Dogon villages, which have remained isolated and traditional; the existence of a savings capacity despite low income levels in the region due to the absence of cash crops; and economic vitality reflected in the presence of numerous markets and an entrepreneurial spirit.

The CVECA network of the Pays Dogon region was created through a project of bilateral cooperation between Germany (KfW[8]) and the Government of Mali, represented by DNACOOP,[9] the state department for cooperatives. The first phase of the project began in 1986. The objective of this pilot phase was to confirm the validity of the approach in Pays Dogon and to proceed with creating some 15 CVECAs in two districts, Koro and Bandiagara. Following on the success of the first CVECAs, the second phase (1989–94) involved setting up 40 additional CVECAs, expanding the network to a third district (Bankass), and refining the structure of the network. Three district associations were created to provide a forum of exchange among CVECAs and to handle financial relations between the CVECAs and BNDA. Also, during this phase, a project component on promoting economic activities was implemented, which consisted of identifying new and profitable economic activities, training entrepreneurs, and developing adapted credit products. During the final phase of the project (1995–June 1997), existing structures were consolidated by upgrading the skills of the actors involved, and a new Service Unit was created in the form of a private, independent firm that provides services such as training and audits to the CVECAs and the district associations.

Until June 1995, expatriate technical assistants recruited by CIDR handled project management. There were three successive project managers, all women. From 1989 to June 1995, CIDR also recruited an expatriate to direct the component on promoting economic activities. In 1996, the Malian team consisted of 10 outreach workers in charge of increasing awareness and understanding of the CVECAs by the villagers themselves, training the managers and management committees, monitoring and inspecting the banks, and providing support to village entrepreneurs. All the project employees were native to the Pays Dogon region and all spoke at least one Dogon dialect.

From June 1995 to June 1997, the director of the Service Unit was responsible for project management. Since then, the project structure[10] has disappeared, leaving only four Service Unit professional staff to provide all services required by the banks and associations. However, the Service Unit has drawn up a request to the BNDA for a grant that would allow continued employment of some outreach workers to support the two urban banks set up in 1997 in Koro and Bandiagara, as well as certain banks in the Bandiagara district that are experiencing difficulties.

One element of the project's success lies in the stability in the donors and management support. From the beginning, KfW was the sole donor, and the same individual monitored the project and renegotiated each project phase. At CIDR, the person who designed the project continues to monitor it even now. At DNACOOP, there have been two successive project managers. The project team has remained relatively stable and the Service Unit staff all have many years of experience with the project.

Expansion

The success of the CVECA approach was evident from the first phase of the project, and CIDR moved quickly (beginning in 1989) to replicate the model in other regions of Mali and other countries of Africa. There are now nine CVECA networks: four in Mali, two in Burkina Faso, and one each in Madagascar, Sao Tomé, and The Gambia. In Cameroon, CIDR is providing support to national organizations for setting up CVECAs. In all cases, adjustments have been made to ensure that the banks are consistent with the local context. The growth of the networks offers ample proof that the CVECA approach can be successfully adapted to very different contexts. In 1996 according to CIDR, all the networks, taken as a whole, constituted 260 banks, 67,500 members including 25,800 women, total savings of US$830,000 and outstanding loans of US$2 million.[11]

A more thorough analysis of the bank network in Pays Dogon is warranted because other CVECA networks continue to draw inspiration from the experience of this particular network.

Organizational Structure of the CVECA Network

The CVECA network is organized into two levels. The individual CVECAs are the basic units and are federated into three associations—one for each district. The Service Unit is a private entity that is independent of the network but is also a key partner insofar as it provides services to the CVECAs and associations that are essential to their success.

CVECAs

Establishing CVECAs

In December 1996, there were 52 CVECAs in the Pays Dogon region. They

[8] Kreditanstalt für Wiederaufbau.

[9] Direction nationale de l'action coopérative.

[10] "The project" refers to the team of foreign and local staff.

[11] Only data for The Gambia was not available. Other financial development programs that CIDR is running such as the women's banks in urban Mopti (Mali) or the assistance to *tontines* (ROSCAs) in Burkina Faso and Ethiopia are not included.

were set up after surveys were carried out by the project to identify the villages that most fully met the criteria of size (no fewer than 500 inhabitants), social cohesion, economic vitality (market proximity), and organizational vibrancy (the existence of groups). Savings capacity and the need for credit were also assessed. General assemblies were then held in selected villages to gauge the motivation of inhabitants to organize themselves for the purpose of forming a savings and loan bank. From the beginning, villagers easily accepted and understood the concept of the banks because it quite closely mirrors the functions of existing traditional groups (neighborhood groups, age-based groups, women's tontines) that offer savings and credit services, albeit with limited resources and rudimentary techniques. Once a letter was received from village authorities (chief and council) confirming the desire to form a bank, the project moved forward with the villagers to initiate the process of setting up the bank.

Managers, the Management Committee, and the General Assembly

As a result of the area's low literacy rate, it proved difficult to identify individuals capable of managing the banks. Numerous training activities were required to transfer the necessary skills. Nevertheless, significant advantages were found in working with managers who were from the village itself: they agree to work as volunteers during the first years of bank operations since this allows them to make a personal contribution to developing the village, and they are known to the other villagers and trusted by them.

All of the banks have one to three tellers responsible for transactions with customers and for keeping the records of accounts. Roughly 60 percent of the banks have a village controller, who is responsible for regularly inspecting the books. This individual checks all bank transactions at least once every 2 weeks. Villages that have been unable to identify a person capable of being trained for this role rely on the controller of a nearby village and pay him or her for services rendered in performing the bank's controls.

Management committees are composed of 6 to 12 men and women, who represent all the neighborhoods of the village. Selection criteria for the members of the management committees are trustworthiness, seriousness, and ability to work hard in the interest of the village. Members of management committees are rarely literate, but they are trained by the project to be able to read and write numbers, monitor and control the activities of the bank managers, and hold the general assemblies. Members are elected for 2 to 3 years, depending on the bank. The management committee generally meets once a week. The role of the management committee is to

- analyze loan applications, decide loan amounts, and inform bank members about decisions made
- oversee proper management of the bank and, in particular, ensure that loan decisions are respected and verify the cash balance at the end of the day
- promote the bank by regularly informing villagers about bank-related developments and hold an annual general assembly to present the legal and financial report

The general assembly is composed of all members of the village, unlike classic cooperatives where only members of the cooperative are invited to general assemblies. Insofar as the bank is an instrument of local development, it is critical that all villagers, even those who have chosen not to join, are kept informed of its progress.

The annual general assembly is held each year in April or May. The managers and the management committee present a profile of relevant indicators and the financial statements as well as an account of the main events that took place within the CVECA network. They receive assistance in preparing their presentation and report from the Service Unit, which sends each bank summary tables and charts of the main indicators as well as financial statements, drawn from data collected during end-of-year audits. The bank managers reproduce the charts on a blackboard and meet with the committee to prepare the general assembly. Together, they apply the techniques they have learned in the training activities organized by the project to draw up the agenda and a list of important issues that need to be addressed. The high point of the general assembly occurs when the profits are allocated. All the villagers in attendance participate in deciding how the profits should be applied to the following: Service Unit fees (which represent 15% of annual earnings), compensation of the managers and management committee, reserves, and a capital increase or an investment for the bank or the village. The annual general assemblies strengthen the sense of ownership that villagers feel toward the bank and heighten their trust because the accounts are presented in a transparent manner and decisions are made jointly.

Products Offered

To benefit from the savings and loan services offered by the banks, villagers must become members. This entails paying a membership fee, the amount of which varies by village and occasionally by membership category (individual or group), ranging from CFAF 250 to CFAF 5,000 (US$0.50 to $10.00). Any villager may become a member of the bank, and individuals residing in the surrounding villages are also invited to join, although there are restrictions on those who live in villages that have their own bank in order to avoid situations where credit is extended more than once, which could lead to sizable debt.

The CVECAs offer three types of savings accounts:

- Current accounts earn no interest and have no upper or lower limit.
- Term deposits are for periods from 3 months to 1 year and earn interest at the rate set by the village, usually 20 percent a year. The interest is paid when the deposit is withdrawn. There is no minimum savings amount.
- Savings plans have been instituted in certain banks to encourage regular savings, particularly by women who like to make very small and regular deposits. The interest rate is 10 percent a year.

Members savings constitute the principal resource of the CVECAs. The credit amount to which an individual is entitled to does not depend on his or her personal savings: a member who has never deposited savings can obtain a loan, although typically he or she will eventually be asked to make an effort to generate savings after receiving the second or third loan. This rule improves access to credit for women, who generally have a lower savings capacity than men due to lower income. It also distinguishes the CVECAs from many savings and loan cooperatives and credit unions where loans amounts are usually linked to savings held.

Three loan products are available:

[12] During their first years of operation, many CVECAs set interest rates on loans at a very high level in order to be able to build up a capital base. As the CVECAs became increasingly profitable, members convened during the general assemblies to ask that the rates be lowered.

short-term loans, loans for entrepreneurs, and medium-term loans. The vast majority of loans are short-term loans granted for ongoing economic activities successfully run by villagers, in an amount that they are able to manage. These loans are also offered for consumption. The term of the loan ranges from 1 month to 1 year. The amount ranges from CFAF 2,500 to CFAF 500,000 (US$56 to $930) or sometimes more, depending on the bank. The loans are repaid in a single installment (principal plus interest) to facilitate the management process. The interest rate is set by the village assembly: the average rate applied by banks in 1996 was 43 percent. The rate has shown a tendency to decline over the past 3 years.[12]

Certain loans require that a feasibility study be performed, either because the activity is new in the area or because the amount requested is large (generally over CFAF 1 million). For such loans for entrepreneurs, the project, through its component on promoting economic activities, has developed a methodology for preparing feasibility studies that involves the management committee, specifically by providing the committee with the skills needed to analyze this type of higher-risk activity. These loans can be short-term or medium-term, and they usually carry the same interest rate as the regular portfolio unless the feasibility studies show that the activity cannot be profitable without a reduction in the interest rate.

Recently, some banks have begun to make medium-term loans (2 to 3 years), usually funded from their equity since savings tend to be for terms shorter than 1 year. These are mainly loans for agricultural equipment (carts, plows, cattle) and artisan activities (looms, blacksmith equipment). In general, the banks lower the interest rate by a few points for these loans, but this raises a particular problem because some members then try to obtain medium-term loans solely to benefit from the differential rate.

Collateral

Collateral is required for each loan and is generally in the form of bicycles, guns, radios, plows, or carts. Most often the collateral holds no book value because, based on age, the item is already fully depreciated. However, the item has a certain market value, depending on how rare or useful it is, and it can easily be sold in the village in the event of a foreclosure, which has already happened. More important, loss of the item would have serious consequences for the owner, who is therefore motivated to repay the loan. But the single most important factor motivating members to pay off their loans is not the physical collateral involved, but rather the social pressure applied by the village. In such a tight-knit society, failure to pay back a loan is tantamount to theft from one's neighbors since most loans are made from village savings. Few villagers would be willing to risk incurring the wrath of the community. In many cases, members of a borrower's family pay off the loan to avoid default, which would bring shame on the entire family.

Interest Rate Policy

Interest is calculated on the entire amount of the loan or deposit once it reaches maturity. The CVECAs do not impose fees or charges on loans and deposits. In 1996, the banks applied an average rate of 43 percent on loans and 21 percent on deposits. Since inflation was 6.5 percent, the real effective rates were 34 percent and 14 percent, respectively.

The interest rates on loans may appear high, but they are set by the villagers themselves and are comparable to the rates applied by traditional village self-help groups. They are well below the rates charged by local credit providers such as shopkeepers and wholesalers. They are, however, higher than the rates authorized by the PARMEC usury law.

To comply with the law, the CVECAs would have to lower their lending rate to 27 percent, thus jeopardizing their financial equilibrium, which is based on a financial spread of approximately 20 points. It does not appear that the rate paid on deposits could be lowered significantly. Because bank members are keenly aware of this rate, any drop could translate into lower savings volume according to Ouattara, Nguyen, and de la Roque (1997). They found that for 68 percent of the 83 members interviewed, the interest rate on deposits was one of the main reasons for joining the CVECA. Security was a major factor for 66 percent of the members, and proximity was a factor for 47 percent. The argument, frequently heard, that small savers are not sensitive to interest rates is not valid in a context where resources are so scarce and savings in the form of livestock remains the preferred alternative. For the 175 persons interviewed (83 members, 92 nonmembers), savings in the form of livestock accounted for 62 to 92 percent of all household savings (the percentage varies by district) because of the social status attached to livestock ownership and because livestock plays a useful role in agriculture. For women, purchasing small livestock for fattening represents the primary source of savings, followed by tontines, which play a significant role in social relations. Bank savings are important for smoothing out consumption patterns and for avoiding the necessity of selling animals when prices are lowest. This form of savings is not attractive, however, unless the interest rates are high.

Given the importance of setting up proper interest rates, it appears that the only avenue left to the CVECAs of Pays Dogon is to negotiate a waiver from the Ministry of Finance on lending rates, until such time as the volume of activity is adequate to achieve fuller coverage of charges with lower rates. A clause to this effect has been included in the agreement to be signed with the Ministry of Finance.

Urban CVECAs

One recent change in the structure of the CVECA network is the establishment of two urban CVECAs, one in the town of Koro and one in the town of Bandiagara, in May 1997. These CVECAs were opened at the persistent request of inhabitants of these towns, each of which has a population of about 10,000. Prior to their opening, the project's outreach workers identified and met with existing groups in both towns over a period of nearly 2 years. They helped the groups develop savings and credit products and organized meetings between groups to explore their interest in creating a common bank. In each of the towns, 10 or so groups have become the founding members of the CVECA, and the leaders of the groups have assumed responsibility for managing the organization. Unlike the rural CVECAs, the urban ones will not extend loans to individuals, but to groups. Individuals will, however, be encouraged to join the banks so that they can make individual deposits. The urban CVECA rate is 24 percent a year on loans and 6 percent a year on deposits. As in the rural CVECAs, the urban ones have one or two managers and a management committee.

It is too early to analyze the performance of the urban CVECAs but given the total lack of financial services and the relatively high level of resources held by civil servants, artisans and traders in the towns (each of the towns has a major market), all indications appear favorable for the banks to achieve a solid record of performance. Nevertheless, the risks of fraud and delinquency are likely to be higher than in the villages, and CVECA managers will have to be cautious.

District Associations

In 1988, the millet harvest in Pays Dogon was destroyed by an invasion of locusts. As a result, villagers withdrew their savings and applied for sizable loans. The CVECAs in existence at that time joined together to request assistance from the project. The project encouraged the CVECAs to define the key elements of their eventual collaboration within an association made up of all the CVECAs in a particular district and to elect representatives to negotiate loans from the BNDA. The BNDA then asked these associations to set eligibility conditions for banks to receive loans. Through discussions, it was decided that CVECAs experiencing loans in arrears in excess of 10 percent (of the total number of loans granted) would not be eligible and that BNDA financing would be limited to 1.5 times the average volume of deposits of the 6 months prior to the loan request so as not to discourage savings.[13] The banks mutually agreed to the principle of a joint guarantee. In addition, the BNDA required a guarantee equal to 10 percent of the loan amount from each CVECA, which is to be deposited in an interest-bearing account at the BNDA.

This progress toward the creation of CVECA district associations and the development of financial relations with the BNDA had been anticipated by CIDR from the time the project was designed, given the scarcity of monetary resources in the area. A KfW credit line had already been opened at the BNDA to allow loans to CVECAs via the associations. However, farmers were unaware of this situation and, as a result, their level of participation in the negotiations was very high.

There are three associations, one in each district. Each association has 10 to 25 CVECA members. The associations hold two general assemblies each year, in which all the CVECAs of the district participate. In general, the points addressed at the general assemblies are as follows:

- overview of the current status of the banks and comparison of performance indicators
- discussion of problems encountered and proposed solutions
- status report on the repayment of BNDA financing and analysis of banks eligible for financing
- progress report of the Service Unit and analysis of any deficiencies noted in the area of bank management
- appraisal of villages that have expressed the desire to set up a bank and measures to be taken to assist them
- report on activities of the board of directors and elections
- statement of association expenditures and resources and budget monitoring

Each association is represented by a board of directors elected by the general assembly. Members of the board of directors serve for a term of 2 or 3 years, depending on the association. The associations have no paid staff. Members of the board serve on a volunteer basis but do receive meal and travel allowances. The role of the board is to

- organize, chair, and facilitate the general assemblies
- monitor the banks' use of financing and their compliance with deadlines
- ensure that meetings with the BNDA concerning the disbursement or re-

payment of financing is well organized

- organize meetings in villages experiencing bank management problems
- maintain a list of village controllers capable of performing audits in banks that do not have a controller, and monitor the quality of their work
- help new villages create their own banks (through outreach and training)

The project has provided each association with a building and two motorbikes and funded the association budgets on a declining basis. Today, all the associations are self-financing. Their main source of revenue comes from managing BNDA loans. The BNDA grants loans to the associations at 8 percent a year, and the associations on-lend these funds to CVECAs at 18 percent. Seventy-five percent of this spread is paid to the Service Unit, leaving 25 percent to cover the associations' operating costs. Other sources of revenue include a fee of CFAF 100,000 (US$185) per CVECA that is charged when services are provided to help new villages set up new CVECAs. This fee permits compensation of managers who are selected by the association to conduct training and outreach sessions. The associations themselves do not borrow from the BNDA since they do not manage a loan portfolio.

The Service Unit

Since 1991, the stakeholders in the CVECA program have been told that the project would come to an end in 1997 and that it was therefore crucial to think ahead of transferring technical and financial responsibilities. This matter was discussed at length during the village general assemblies and during the inter-bank association meetings. The CVECAs and the associations identified the tasks that they could take over and the tasks where professional staff would be required. Early on, they saw the need to create a small technical organization capable of providing services to the CVECAs and the associations, and they suggested the names of the staff that they wished to see working in this Service Unit. Thanks to this participatory process, the withdrawal of the project team was well planned.

The Service Unit was set up as an independent private firm in 1995 by three Malian staff members of the project. Its primary role is to provide services to the three associations and the CVECAs, but it is also allowed to work with other clients. The director of the Service Unit was previously the counterpart of the project manager, on loan from DNACOOP. He agreed to resign from the civil service in order to participate in creating a private and totally innovative organization. Since June 1997, one more person, also originally from the project, has been on board to help strengthen the team. The four professional staff members are supported by a driver, a security guard, and a secretary/bookkeeper. In addition, the project has provided the Service Unit with a building, a four-wheel drive vehicle, and three motorbikes.

Each year in December, the Service Unit professional staff meets with the delegates of the three associations (called the inter-association meeting). They assess implementation of their contract for the year that is ending and sign a contract for the next year based on Service Unit specifications, which stipulates the number of person-days to be devoted to each activity: performing CVECA audits and inspections (twice a year), conducting audits of association accounts, preparing progress reports and financial statements at both levels, training village controllers

[13] Currently the limit is set at two times the average deposits for the CVECAs that have received two consecutive BNDA loans and have not had any difficulty in repaying the loans.

and association treasurers, participating in village general assemblies and district association meetings, and representing the network at government offices and certain national and international conferences. Overall budget and revenues are assessed to make sure that the budget is balanced. The two main sources of revenue—15 percent of the annual earnings of all CVECAs, and 75 percent of the amount collected by associations on the financing spread—were not dictated by the Service Unit but proposed and agreed on by all the banks during the district association meetings and the consultations leading up to the establishment of the Service Unit.

The inter-association meetings are characterized by intense discussion and negotiation. CVECA delegates are not reluctant to point out the difficulties encountered in fulfilling their contracts (tardy execution of certain tasks by the Service Unit staff, inadequate quality of services) and the Service Unit emphasizes all the shortcomings it has observed. These moments of critical analysis allow network members and the Service Unit to improve their operations and the quality of the services provided.

The most salient feature of the Service Unit is that it is *external* to the network of CVECAs. It negotiates its contracts with the district associations. The staff of the Service Unit manage their own business and are not the paid employees of the CVECAs. This innovative scheme was selected to

- minimize costs and avoid creating a top-heavy federation
- avoid tension and conflict over the relative skills of elected officials and salaried employees, which frequently arise in savings and loan cooperatives (Fruman 1997)
- provide the Service Unit staff with greater autonomy to expose shortcomings and problems
- enable the Service Unit staff to introduce new ideas to the network through contracts implemented for third parties

Although bank representatives would have preferred to have the Service Unit working for the CVECA network full-time, they agreed to the principle that the Service Unit would contract out with other clients because this helps cover total costs. They have also agreed that a portion of the consultancy fees be retained by the Service Unit staff independently.

Problems are inevitable when services as vital as bank inspections are entrusted to an outside entity. Delegates of the associations worry that they may be neglected by the Service Unit to the benefit of other, more lucrative clients and that the quality of services rendered may therefore be declining. They also worry that they are in a weak position when they contract with the Service Unit because the latter is, at present, the sole entity capable of providing the services required. If relations with the Service Unit should deteriorate, to what other service provider could the network turn? The only persuasive response is that the Service Unit is not attempting to maximize its profits and that it is totally committed to the network's success.

Nevertheless, some of the Service Unit staff admit that they are unlikely to spend many more years in such a difficult role, particularly in light of the fact that they have all worked for the project for at least 6 years. They work long hours and frequently travel to the villages, under extremely difficult conditions. Moreover, Service Unit expenses have been reduced to a strict minimum so that the network can become self-financing. The budget does not include training expenses, and the time budgeted for external relations and administrative work appears to have been underestimated. Although the wages paid are reasonable, they are lower than the salaries that the professional staff could receive if they worked for NGOs or international institutions, which are likely, sooner or later, to entice them away, given the fact that microfinance is now fashionable in Mali and that relevant skills are scarce. The staff of the Service Unit are aware of this situation and they are committed to preparing their successors in case they should eventually leave.

Structural Principles

Analysis by Chao-Beroff (1997) has shown that the CVECA network is built upon the principle of subsidiary relations. Only the functions that cannot be managed at a lower level are entrusted to a higher level. A CVECA can exist all alone because "it encompasses all the vital functions of a small financial institution" Chao-Beroff (1997). It collects savings, it makes decisions concerning loans and management policy, and it is responsible for its own management and oversight. In the absence of a district association and the Service Unit, it could survive, even if its activities were thereby reduced. Similarly, the associations and the Service Unit could continue to exist if one of their members or clients should leave. If one of the associations should fall behind in its payments to the BNDA, the other associations would remain untouched by this problem because they are not bound by a joint guarantee. This is essentially a "firebreak" strategy designed to avoid a situation where failure at one level leads to failure either downstream or upstream, or where the defection of a single entity jeopardizes the existence of the others. The overriding principle is to insulate grassroots CVECAs from the effects of a crisis occurring at a higher level.

In addition, the network is built upon a strong sense of ownership. The impact study confirmed that members feel a total sense of ownership toward their CVECA. The services provided by the CVECAs are very useful to villagers, and the villagers understand that the future of their CVECA depends on the quality of their collective management. At the association level, delegates are similarly enthusiastic and devoted to the success of the network. Involving all stakeholders has clearly contributed to the network's healthy growth.

Growth In Outreach

The growth of the CVECA network in Pays Dogon has exceeded all projections. At the beginning of the project, no one could have anticipated the degree of commitment displayed by stakeholders, which has led to high membership levels, real savings capacity, high demand for credit, high repayment rates and increased access to BNDA loans.

Membership

On December 31, 1996, the network had 21,495 members, i.e., approximately 17 percent of the adult population of the Pays Dogon region and 67 percent of the adult population in villages where banks are located (versus 44 percent in 1993). These statistics confirm the extraordinary enthusiasm of villagers for CVECA. The size of the banks has grown rapidly: the average bank has 413 members, compared with 227 in 1993.

Interviews with 83 CVECA members sheds light on the principal characteristics of the membership: 50 percent are heads of households, 81 percent are farmers and 65 percent of them have a second occupation, 8.5 percent are literate in French and 14 percent in Dogon (only 2.5 percent of women can read and write in French). On average, the members interviewed are 43 years old and belong to families of 10 persons (Ouattara, Nguyen, and de la Roque 1997, 39–41).

The profile of members was strikingly close to that of nonmembers (92 nonmembers were interviewed). Although members and nonmembers appear to have similar living conditions. However, income analysis indicates that on average nonmembers in the sample are 48 percent wealthier than members. On the other hand, it is also clear that the poorest inhabitants of the villages are nonmembers because the median income for nonmembers (CFAF 83,875) is lower than for members. Thus, the CVECAs seem to appeal to individuals who are neither the poorest nor the wealthiest segments of the population. The poorest villagers (widows, the elderly, heads of large households) rely on charity.

Women make up 29 percent of the members, compared with 33 percent in 1993. The percentage of women members is decreasing because most new members come from surrounding villages and tend to be men who move more freely beyond the boundaries of the village than women. Inhabitants of villages where no CVECA has been set up represent 34 percent of the total membership, versus 19 percent in 1993. This situation entails certain risks for the CVECAs: the composition of the management committees no longer reflects the composition of the membership as accurately as before, which raises the issue of representation, and the risk of defaults is higher because committee members have greater difficulty monitoring loans.

During 1996, only 51 percent of the members were active, meaning that they were involved in at least one bank transaction, related to either savings or a loan.[14] This proportion appears low and warrants further analysis. Why do nearly half the members not avail themselves of bank services? Have they been disappointed by the services provided in the past? Did they join a bank solely because of village solidarity, with no real desire to participate? Do they expect to use the bank in the future? Do they prefer to use other financial services?

Unfortunately, this issue was not addressed during the impact study carried out in 1997. The study did show, however, that the members who were interviewed deposit 39 percent of their cash savings in the CVECA, and they place 43 percent in traditional village groups, in tontines, or with trusted individuals. The remaining 18 percent of savings are used to make loans to relatives or friends. Thus, CVECA deposits are evidently not the preferred form of savings, although 47 percent of members state that they prefer depositing savings in the CVECA. It appears that the emergence of the CVECAs has not caused villagers to abandon traditional forms of savings; moreover, they continue to diversify their savings between savings in kind and social savings. On the other hand, CVECAs offer true competition to traditional forms of credit because they are the sole primary source of credit for members, accounting for 90 percent of their loans. Compared with nonmembers, the members interviewed have access to credit amounts twice as high, extending over longer periods (120 days versus 45 days in village groups) and at more favorable interest rates (40% versus 120%) (Ouattara, Nguyen, and de la Roque 1997, 42–43). One might therefore conclude that inactive members are those who prefer more traditional forms of savings or who wish to avoid personal debt.

Women probably represent a major

Table 1. Breakdown of CVECA deposits, 1996.

Deposit size (CFAF)	Term deposits (%)		Current accounts (%)	
	By number	By volume	By number	By volume
Below 25,000	77	14	68	8
25,000–250,000	21	52	27	32
250,000–2,500,000	2	34	4	40
Over 2,500,000	0	0	1	20

Source: Chao-Beroff 1998.

portion of inactive members. The impact study suggests that for women, CVECA loans are not the best solution to their problems. They deposit little, preferring instead to purchase animals for fattening or items for a daughter's trousseau. In addition, they fear family and village pressures and shame that would fall upon them if they were unable to repay a loan. Thus, they prefer borrowing from their husband or relatives or waiting their turn in a *tontine* (Ouattara, Nguyen, and de la Roque 1997, 24–25).

Deposits

The total volume of term deposits was CFAF 158 million (US$294,000) in December 1996, an increase of 180 percent over 1993 in real terms). The total volume of current accounts was CFAF 15 million (US$27,000).

The average amount of term deposits in 1996 was CFAF 62,500 (US$115), representing an increase of 90 percent over 1993 in real terms, with deposits ranging from CFAF 2,500 to approximately CFAF 2 million (US$5 to $4,000). The average period of term deposits was 6.3 months, compared with 5 months in 1993.

It is surprising that, in terms of volume, 60 percent of current accounts are in amounts over CFAF 250,000 (US$463) (table 1). It would be logical to suppose that such large amounts would have been placed in term deposits in order to benefit from the attractive interest rate offered by this product, but it appears that large depositors use the bank as a way to keep their savings secure for a short period before investing them in livestock or some other economic activity. In terms of numbers of deposits in the CVECA network, the great majority are in very small amounts, which translates into high transaction costs for the CVECAs.

Depositors constitute a minority of CVECA members: they accounted for only 13 percent of all members in 1996 (about the same as in 1993). Women represented 18 percent of all depositors, reflecting a steady decrease since 1993 when they represented 24 percent.

Even though CVECA deposits do not constitute tremendous volumes in comparison with other networks in West Africa and around the world, they have a dual significance. They have heightened the bank network's autonomy in relation to donors and the sense of ownership felt by members. Just as important, bank savings play a significant *protective* role. Opportunities to save are nearby, easily accessible to inhabitants of the village and neighboring villages, liquid (particularly for current accounts), safe and inexpensive (with no account maintenance fees), and even offering attractive earnings. Such savings serve to reduce household vulnerability: households with savings are better equipped to deal with emergencies. Nevertheless, it certainly appears that the true driving force behind the CVECAs is loans rather than savings.

[14] Out of all the members, 13% deposited at least once during the year and 39% took out at least one loan.

Table 2. Breakdown of CVECA loans by amount, 1996.

Loan size (CFAF)	Number (%)	Volume (%)
Under 25,000	59	13
25,000–250,000	36	58
250,000–2,500,000	4	29
Over 2,500,000	0	1

Source: Chao-Beroff 1998.

Loans

During 1996, 13,213 loans were made (60% more than in 1993), totaling CFAF 653 million (US$1.2 million). On December 31, 1996, the outstanding loan portfolio amounted to CFAF 418 million (US$775,000), reflecting real growth of 310 percent since 1993. The average outstanding loan amount in 1996 was CFAF 49,400 (US$136), i.e., an increase of 54 percent over 1993 (in real terms). The average term was 6 months, up from 4.1 months in 1993. The distribution of loan amounts is presented in table 2.

In 1996, loans below CFAF 25,000 accounted for 59 percent of all loans and 13 percent of the volume of all loans. The statistics reflect a trend that has been observed since the banks were opened: the number and volume of small loans are declining at the expense of loans in excess of CFAF 50,000. This situation can be attributed to the facts that the majority of clients have received more than one loan to date and that with each loan, the amount tends to increase. Members gradually develop their activity and are willing to assume greater debt after successfully paying back one or two loans. Also some of the wealthier villagers probably only joined the CVECAs once they had seen it operate for some time and were convinced of its ability to provide quality services. The loan amounts these clients require are larger than those of the original members.

In 1996, 39 percent of members received loans versus 44 percent of members in 1993. Thirty-three percent of the borrowers were women, the same as in 1993. These figures appear relatively low when compared with the findings of the impact study. Among the 83 members interviewed, 93 percent indicated that the main reason they had joined the bank was to gain access to credit. In general, the only applications rejected by the banks are those made by individuals with a poor repayment history or by questionable clients. For all other clients, the banks prefer to reduce the requested amount if resources are scarce, rather than refuse to grant a loan. Additional research is needed to understand why, each year, an average of 60 percent of members do not access credit, and whether it is the same clients each year. Such research could determine whether the explanation lies in excessive personal debt levels, access to other resources (including personal funds), dissatisfaction with the CVECAs, lack of business opportunities, or some other factor.

The data gathered by the project from the CVECAs' loan records provide a breakdown of loans by purpose in 1996: 82 percent for trade, 13 percent for agriculture and stockraising, and 3 percent for consumption (compared with 76%, 18%, and 4%, respectively, in 1993). In reality, social loans are probably more numerous than these statistics suggest. Many clients do not dare state a social purpose for fear that the bank will reject their loan application or because they do not want others to know that they are experiencing difficulties. Moreover, almost all loans granted for economic activities, particularly loans to women, are partly used for consumption. Individual interviews conducted by the author reveal that women often use a portion of their loan to purchase food or clothing for children. This situation, of which everyone is aware, is well accepted.

The management committees do not control the way loans are used, preferring to trust members to use borrowed sums rationally, in a manner that will guarantee repayment.

Like savings, consumption loans provide members with an instrument of protection since they enable borrowers to deal with unforeseen circumstances (a failed harvest, an illness) and to even out their expenditures. Promotional loans (i.e., loans granted for economic activities) are an indispensable complement. They enable entrepreneurs to increase their income and accumulate assets, while taking greater risks.[15] In Pays Dogon, the project has attempted to identify and disseminate information on new dry-season activities as a way to reduce families' reliance on agricultural activities, which entail high risk since they are totally dependent on the climate. This awareness has led to the development of certain artisan businesses (blacksmithing, weaving) and, in particular, has provided assistance to individuals trying to develop microenterprises. Thus, it has played both a protective and a promotional role. Many microfinance institutions exclusively grant loans for economic activities, thereby poorly addressing the needs of the most disadvantaged segments of the population because they do not offer protective products (savings, consumption loans, loans for low risk economic activities). The CVECAs of Pays Dogon have managed to avoid this pitfall and, as a result, cater to a larger range of clientele.

The data provided by the Service Unit on delinquency present serious anomalies and, as a result, are not reliable. The Service Unit reports a 99 percent recovery rate after 1 month and, similarly, a 99 percent recovery rate after 1 year. This would represent an improvement over 1993, when the rates were 94 percent and 99 percent, respectively. Yet the situation has tended to deteriorate over time. Certain banks in the Bandiagara district are in a precarious situation, with total delinquent loans approaching 40 percent of the total volume of outstanding loans in April 1997. The errors made by the Service Unit are related to its method of calculating the arrears rate (with the recovery rate considered equal to one minus the arrears rate). The arrears rate is calculated by dividing the average amount of loans in arrears of more than 1 month (or more than a year) by average loan portfolio for the year. Since the Service Unit audits each bank only twice a year, it has had difficulty obtaining the data needed to calculate average loans in arrears and, as a result, the figures used are rough and erroneous approximations that underestimate the true situation. These errors should be corrected as quickly as possible by adopting a more precise method of measuring arrears. Also measures should be taken to rectify the situation in CVECAs with significant delinquency.

Financing

The remarkable growth in outstanding CVECA loans would not have been possible without financing from the BNDA. On December 31, 1996, the outstanding amount borrowed from the BNDA by the district associations amounted to, in real terms, CFAF 150 million (US$300,000), i.e., a 610 percent increase in real terms over 1993 (figure 1). BNDA financing has played an important role in the growth of the CVECAs. In 1996, the ratio of outstanding financing to outstanding loans was 55 percent, compared with only 32 percent in 1993. The rapid growth in financing has occurred

[15] The concept of promotional and protectional financial strategies was developed by Hulme and Mosley (1996).

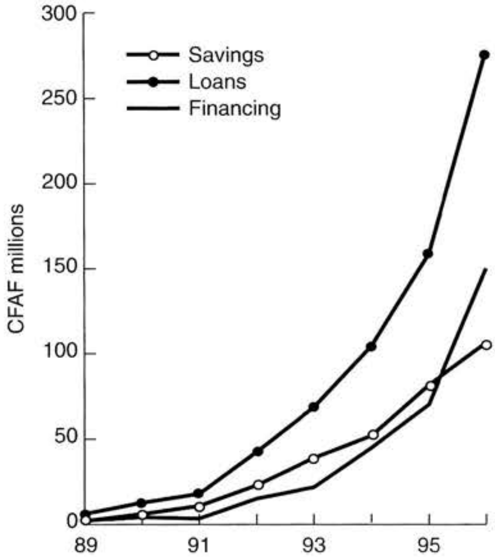

Figure 1. Profile of outstanding balances of CVECA savings, loans, and financing in real terms (1993 CFA francs), 1989–96.

without lowering the 100 percent rate of on-time repayment to the BNDA.

The BNDA loans to the associations are supported by a credit line opened by KfW. This credit line does not bear interest but the BNDA is obligated to constitute a reserve fund equal to 3 percent of recovered loans that is intended to finance decentralization of the bank's operations or to support emerging microfinance institutions that are its partners. From this fund, the BNDA will be able to finance the Service Unit's request to maintain some outreach workers in their positions. The BNDA extends its loans at 8 percent a year, the same rate that it offers its best agro-industrial clients. This rate entails a discount of about 4 points in comparison to agricultural loans granted by the BNDA, typically at 12 or 13 percent a year. The associations have turned out to be profitable clients because the transaction cost on loans granted to them is minimal. Each transaction entails a large sum, which is later recovered in a single installment, and the analysis performed is concise. The BNDA relies heavily on the guarantees provided: the relationship of trust with the clients, mutual guarantees among CVECAs, and a deposit equal to 10 percent of the loan amount. Until now, the BNDA also knew that it could rely on the technical assistance provider, CIDR, and the project staff to supervise the use of the loans by the CVECAs. It is yet to be seen if the BNDA will trust the Service Unit enough to delegate this monitoring function to it.

The question that inevitably arises is whether the BNDA will still agree to grant loans to the banks once technical assistance has been withdrawn and, in particular, once the BNDA no longer has access to a KfW credit line. When it is called upon to use its own resources, will the BNDA continue to offer loans at 8 percent? Will it require additional guarantees that could seriously complicate the current procedures? One of the BNDA's first requirements might be that the accounts of the associations and CVECAs be audited each year by an outside firm. This would no doubt enhance the reliability of CVECA management but would also increase operating costs and possibly strain the network's financial self-sufficiency.

Accounting Procedures and Financial Performance

Accounting Systems and Controls

At the CVECA level, management is performed manually by the manager-bank teller. Because of the low educational level of the managers, accounting operations have been extremely simplified. As an example, operations are separated into only 15 accounts, using very simple documents. There is currently no formal procedures manual, but the Service Unit is considering drawing up a manual for CVECA tellers and controllers. However, training courses are held frequently.

The records of accounts are regularly inspected by the management committee and the internal controller from the village. The management committee verifies that the loan disbursements are consistent with the decisions made and that outstanding amounts correspond to those inscribed in the books. The committee also monitors principal indicators of growth on a performance chart posted in the CVECAs. Either weekly or biweekly, the village controller checks all operations by examining the accounting records, then determines the forecasted loan disbursements indicating cash flow and amounts available for lending. Since deposits are used to fund loans locally at each CVECA level, there are no financial operations between banks, and surplus cash is never transferred to the associations.

Every 2 or 3 months, each CVECA is visited by a controller from another village who has been approved by the association and paid in accordance with a set fee schedule. These controllers have been trained by the project to identify and resolve accounting problems. Their work is complex because some CVECAs record a great number of transactions. Locating and correcting an error can be time-consuming, particularly when the village-level managers are largely uneducated and do not keep careful records.

The third level of inspection is provided by the Service Unit, which audits all the CVECAs every 6 months. The Service Unit also intervenes whenever an association informs it of urgent problems in any of the CVECAs, and it performs unannounced inspections. This amounts to a heavy workload for the Service Unit's four professional staff members. In the larger CVECAs, an audit may take more than 4 days to complete. During these visits, performance indicators are calculated and financial statements prepared. In a similar fashion, Service Unit staff members audit the accounts of the associations and prepare their financial statements. When they return to the office, they use a computer and a simple worksheet to process the data collected.

The chief characteristic of all the accounting documents and the various stages of management and control is simplicity. Since most of the managers have a limited educational background, it was important to design simple accounting procedures. Service Unit staff were recruited without emphasizing skills in management and finance. Although the system worked well during the network's first decade, when the volume of savings and loans remained relatively low and easily manageable, weaknesses are beginning to appear. Some managers are overwhelmed and make mistakes that the controllers are not always able to correct. In certain CVECAs, the growth in arrears reflects this situation. Furthermore, the Service Unit is essentially powerless with respect to certain problems:

- The operations to be straightened out at the end of the year are becoming more numerous and more difficult to process.
- The determination of the arrears rate and the provisioning for loan losses are growing increasingly complex.
- Instituting legal procedures to recover funds is becoming urgent in certain situations.

The Service Unit receives many conflicting messages from the Ministry of Finance, from donors, and from specialists in microfinance.[16] Each suggests different

[16] Currently the Service Unit draws up the financial statements for each CVECA on an accrual base but this is time-consuming and the Service Unit staff wonders to what extent it is necessary, knowing that most microfinance institutions have cash accounting.

ways to measure arrears, calculate interest, and assess institutional performance. It is difficult for the Service Unit staff to select the methods most appropriate to the CVECAs. Support from an expert in accounting and management would be of great help in setting up rules and systems and providing timely assistance to the network.

Financial Performance

It is difficult to measure accurately the network's financial performance because all the necessary data are not available or were insufficient at the four institutional levels: CVECAs, associations, the Service Unit, and project. The CVECAs' financial statements were correct except for certain errors in recording provisions (the balance sheet does not show a provisions account) and the practice of grouping management expenses together in a single category, which does not permit a very detailed analysis. No balance sheet was prepared for the associations for 1995 and 1996. The 1996 Service Unit financial statements were prepared by a Malian accounting firm, with no indication, however, of depreciation of fixed assets. Finally, it was difficult to analyze the project budget because it includes a portion managed in the field and a portion managed by CIDR headquarters in France. The latter portion covers technical support missions and some training activities, but CIDR headquarters does not report the amount of such expenses to the project in the field. As an example, two of the Service Unit staff members attended lengthy training programs overseas during the course of the year, but they are not aware of the cost of the training. For all data partially or completely unavailable, estimates were made. As a result, the following analysis is not perfectly accurate.

Operational and Financial Self-Sufficiency

This analysis focuses on the consolidated accounts of the entire network: CVECAs, associations, project, and the Service Unit. It demonstrates that the network of CVECAs in Pays Dogon is rapidly approaching financial break-even. In 1996, operational self-sufficiency was 94.7 percent, versus 29.3 percent in 1994. Adjusted financial self-sufficiency came to 63.5 percent in 1996, versus 25.5 percent in 1994 (table 3).

The subsidy dependence index (SDI) is declining rapidly as well.[17] From 370 percent in 1994, it fell to 162 percent in 1995 and 78 percent in 1996. This means that, to cover all the network's costs, CVECAs would have had to increase their interest rate on loans in 1996 by 78 percent, up to an annual rate of 76.5 percent. However, since costs seem to be decreasing rapidly, the SDI should approach zero in 1998, in which case the existing interest rate would be adequate. Success in achieving financial break-even will mostly depend on the need for grants to retain some of the project staff in their positions

Table 3. Consolidated accounts of banks, associations, project and service unit.

Year	Financial revenues (CFAF millions)	Financial costs (CFAF millions)	Operating costs (CFAF millions)	Adjustments (CFAF millions): Inflation	Adjustments (CFAF millions): Subsidized borrowing	Adjusted operating costs (CFAF millions	Operational self-sufficiency (%)	Adjusted financial self-sufficiency (%)
1994	33.4	14.3	113.8	1.1	2	116.9	29.3	25.5
1995	60.6	21	119.9	4	3.9	127.8	50.5	40.7
1996	104.4	44	110.2	3.7	6.6	120.5	94.7	63.5

a/ Financial revenues divided by operating costs.

b/ Financial revenues divided by the sum of financial costs and adjusted operating costs.

to assist the weakest CVECAs.

The CVECAs are a highly profitable level of the system. All the CVECAs except three made a profit in 1996. The three that did not show a profit suffered from deteriorating arrears. For all others, their low costs contributed to their profitability. The managers and management committees work on a volunteer basis, but do receive some compensation at the end of the year from profits earned, in an amount set by the village assembly. In CVECAs with a large volume of activity, this compensation can amount to the equivalent of a schoolteacher's salary for each of the managers. However, the fact that such compensation is drawn from profits earned helps to ensure that the banks remain profitable.

Management documents are simple and are printed locally at low cost. Expenses for training activities and for monitoring loan recovery are also low. The banks' profitability can also be attributed to the high ratio of savings, which are used to fund loans (93% in 1996). This rate can be maintained at such a high level without jeopardizing members' savings because of the excellent repayment rates achieved in the past. The banks' ability to repay savers on time is almost guaranteed, provided that managers are very careful in calculating the loan terms.

The associations cover their own costs as well. Only the Service Unit does not yet cover all its costs. In 1996, the rate of coverage was 90 percent, with a professional staff of three. However, because of the workload, a fourth staff member was recruited in 1997. Projections prepared by the Service Unit indicate that it will cover 79 percent of its costs in 1997 (total budget of CFAF 25 million) from fees paid by the CVECAs and associations. The remainder will be covered by outside funds. The Service Unit should achieve financial self-sufficiency based on network fees in 1999.

The improved profitability of the bank network can be attributed to two factors. First, financial revenues have grown significantly, while loan-loss provisions represent but a light burden. Second, costs have declined considerably. Functions handled by the project have gradually been transferred to local actors, in particular, the Service Unit, the associations, and CVECAs. There is very little paid staff. Most people in charge of the management of the network work as volunteers, receiving only small financial incentives.

The system's financial sustainability will rely on a further reduction in costs, which may increase risk in the system. The Service Unit staff already have a heavy workload. When one person is absent, either for training or due to illness, the others are seriously overburdened. The Service Unit's budget is so tight there is no budget for training activities. Yet the staff need considerable training in accounting and management and should indeed pursue professional training. Must training be sacrificed to the goal of achieving financial self-sufficiency? Or is it expected that donors will continue to fund these activities by providing subsidies? Furthermore, until now the Service Unit has benefited from tax exemptions because it was operating under the auspices of a bilateral cooperation project. The cost of such taxes (particularly on purchases of imported equipment such as vehicles, motorbikes, tires, spare parts, and computers) could amount to several million CFA francs. In the present situation, the Service Unit is somewhat fragile and insufficiently prepared to face all the contingencies that may arise.

However, it should be noted that the sums in question are small. In 1995 the

[17] For more information on the SDI, see Yaron 1992 and Gurgand, Pederson, and Yaron 1994.

network recorded a shortfall of US$140,000. In 1997, the Service Unit is forecasted to come within just US$9,300 of covering all its costs tax-free. The contracts signed with the United Nations Capital Development Fund (UNCDF) to set up new CVECAs in Bankass and with Itinéraire de Formation-Diffusion, a microfinance training program, to receive trainees should make it possible to cover these costs. Even if the network continues to rely on grants from donors or the BNDA to keep two or three outreach workers in place so they can continue to support new activities such as urban banks, as well as weak CVECAs, the required amounts would be small.

Future Prospects

Although the financial structure of the CVECA network presents some risk, the CVECAs of Pays Dogon rest on solid foundations that should guarantee their sustainability. Local and national government officials want the network to succeed and should not interfere with its activities. DNACOOP, which has supported the project from the outset, clearly understands the importance of encouraging private initiative and minimizing the role of the state in this type of network. The CVECAs have been visited by top government and BCEAO officials, who also took part in the project's closing workshop in 1997, and they have all indicated their support for a waiver to the usury law and flexible enforcement of the PARMEC law.

In addition, the villagers' sense of ownership of the CVECAs is significant, and management is prepared to make efforts to ensure that the CVECAs continue to develop in the future. These efforts go beyond the village level because many committee members and managers are now offering support to set up new CVECAs. The plan is for district associations to provide support in establishing two or three new CVECAs each year. In Bankass, this process will be complemented by the efforts of the Service Unit, which has been asked by UNCDF to set up 20 CVECAs. In Koro, village demand is high and two new CVECAs were established in 1997. This momentum should continue or even increase in the future. The real problem is in Bandiagara district, where CVECA closings are likely in coming years because of a lack of motivation and solidarity in a large number of CVECAs. The rapid growth in arrears at many banks in the district is evidence of this. At least five or six CVECAs in Bandiagara have survived in recent years solely through the efforts of project outreach workers. Once this assistance, analogous to life-support, is withdrawn, these CVECAs are likely to collapse.

The role that the urban CVECAs will play within the network has not yet been settled. What type of relationship will the urban CVECAs have with the rural ones? Will they participate in the district associations? Will they contract directly with the Service Unit? The late emergence of the urban CVECAs, within months of the project completion date, has left these questions unanswered. If the BNDA does not fund the additional budget request from the Service Unit, the responsibility for monitoring the urban CVECAs will fall on the Service Unit even though these new CVECAS are in no position to pay for services rendered and have very high needs for monitoring and training.

Three actions are recommended to ensure that the network continues to grow smoothly: the development of new accounting tools and an improved management information system, professional training for all actors, and an effort to keep arrears at a low level.

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BENIN

FECECAM

Cécile Fruman

Benin's Fédération des caisses d'épargne et de crédit agricole mutuel (FECECAM), has become one of the largest credit union networks in Africa. The experience of this federation provides a remarkable example of an effort to rehabilitate and rejuvenate a credit union network handicapped by extensive government intervention and mismanagement. FECECAM is now on the path to profitability, but its daily management and strategic options for the future still present numerous areas of risk and uncertainty. Lessons drawn from FECECAM's experience may prove useful to other credit union networks seeking to improve their performance.

Background

Structure

FECECAM is a credit union network that mobilizes deposits and provides loans to its members. Loans are funded almost exclusively by these deposits and a deliberately limited amount of external lines of credit. In 1995, for instance, donor lines of credit funded 15 percent of the loan portfolio on average. Members of the local credit unions, CLCAMs,[1] are farmers, traders or self-employed workers living in communities covered by the CLCAMs.

FECECAM, like most credit unions, is structured in a pyramid. In the bottom tier of the pyramid are 62 CLCAMs, which deliver financial services to their members.

In the middle tier are seven regional unions,[2] which play no role in financial intermediation for individual clients, but offer important support services to the CLCAMs. Each regional union supports an average of nine CLCAMs and is responsible for inspecting the CLCAMs and monitoring their accounts and operations. They are concerned in particular with the adequate implementation of loan policies and loan recovery procedures; managing training activities for CLCAM employees, elected directors, and members; and pooling excess liquidity.

The top tier is the federation, which was founded in 1993 to carry out national policies for the network. It is responsible for developing accounting and financial procedures, as well as preparing accounting manuals, inspecting the CLCAMs and the regional unions, computerizing the CLCAMs, monitoring the CLCAMs' activities, and developing new products.

Directors elected by the members of the CLCAM are responsible for managing the regional unions at all levels. Daily operations, however, are conducted by paid

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staff who must respect the decisions made by the elected directors. The board of supervisors (also elected by the members) supervises the work of both the board of directors and the paid staff. All elected representatives on both boards are volunteers, but they receive per diem compensation for attending meetings or training.

Each CLCAM has a board of directors (13 to 15 persons) and a board of supervisors (five persons) that are composed of members from the different villages that the CLCAM covers. The board of directors is responsible for

- raising awareness of the services offered by the CLCAM, as well as the importance of savings and timely repayments of loans
- analyzing loan applications, determining who will obtain a loan, and ensuring timely repayment through borrower follow-up
- budgeting the activities of the CLCAM
- taking all decisions that have to do with the general management of the CLCAM (as opposed to the day-to-day decisions that are made by paid staff—the CLCAM manager, tellers, and accountant)

The board of supervisors is responsible for

- monitoring daily operations, i.e., ensuring that cash on hand is consistent with the books and that loans have been processed according to the decisions of the board of directors
- seeing that policies are being respected and that the board of directors and the staff are working in harmony
- verifying expenses

The boards of directors of the regional unions are in charge of monitoring the CLCAMs to ensure that they are performing well and to intervene in case of difficulty. Similarly the federation monitors the regional unions. The paid staff are involved in this monitoring, but at a more technical level. The regional unions each have a staff of about 15, whereas the Technical Secretariat of the federation (TSF) has 33 employees.

History

FECECAM's history dates back to the 1970s. In 1975, CNCA,[3] the national agricultural credit bank, was established as a public development bank, followed in 1977 by CLCAMs, the first local credit unions, and CRCAMs,[4] the first regional credit unions. In the next 10 years, 99 CLCAMs were created: 35 permanent facilities and 64 affiliates offering services on a periodic basis. CNCA then assumed the role of a national federation, taking control of the operations of the entire network and excluding the elected directors from management and control. As a result, rules and procedures were developed by CNCA management and imposed on elected directors and members. Thus the constituencies being served were unable to voice their concerns and demands. This top-down approach proved to be highly detrimental.

The network financial performance slowly deteriorated to the point that savings were no longer secure. In November 1987, CNCA was liquidated. The CRCAM assets held by the CNCA, totaling more than CFAF 450 million (US$1.8 million), were frozen, causing a liquidity crisis for the local and regional credit unions and resulting in a freeze on most deposit accounts. The bankruptcy of CNCA and the CRCAMs can be attributed to several factors:

[1] Caisses locales de crédit agricole mutuel.

[2] Unions régionales des caisses locales de crédit agricole mutuel.

[3] Caisse nationale de crédit agricole.

[4] Caisses régionales de crédit agricole mutuel.

- a particularly difficult economic environment, notably a crisis in the main agricultural and agro-export subsectors and problems throughout the banking sector (the whole banking system in Benin collapsed in 1988)
- interest rate spreads that were much too narrow due to government restrictions
- the time-lag between mobilizing deposits and disbursing loans, and lax management of loans, resulting in considerable loan delinquency
- operating costs that were much too high relative to limited and uncertain revenue
- management by staff who had little incentive to focus on profitability, but who were paid in accordance with the favorable banking labor convention, which guaranteed high salaries (Doligez, Fournier, and Gentil 1993)

Nevertheless, a study carried out by IRAM[5] in 1988 showed that the local credit unions had continued to operate throughout the crisis and that member savings had continued to grow. To strengthen the autonomy of the network, the government decided to initiate a rehabilitation program. It emphasized the importance of the CLCAMs having total freedom to define their own policy, including the choice of interest rates.

The first phase of the rehabilitation program (1989–93) was developed in collaboration with the government, members of the network, and donors contributing funds to reimburse depositors, finance studies, and cover the operating shortfall of the network.[6] The following actions were undertaken: 57 CLCAMs were closed, leaving a network of only 42; staff size was cut; and an external firm carried out annual audits and inspections of all CLCAMs. The results of the first phase were encouraging insofar as the project met its principal objectives—restoring the rural population's confidence in the network, strengthening management by elected directors, and improving financial discipline.

The renewal of confidence was quite clear. Membership rose from 20,800 in September 1989 to nearly 40,000 in June 1992. Over the same period, deposits increased 11 percent, reaching CFAF 3.1 billion (US$12.4 million). Credit extension took a major step forward, with nearly 8,500 borrowers and CFAF 310 million (US$1.24 million) in outstanding loans by September 1991. By 1993, more than half of the local CLCAMs had reached a break-even point or were showing a profit.

The success of the first phase and, in particular, the enthusiasm demonstrated by the principal participants, led to the launching of the second phase of rehabilitation (1994–98). The objectives were

- financial restructuring of the network, both to mobilize deposits for on-lending and to generate revenue to cover operational expenses
- a transfer of responsibility to elected directors through the creation of a national federation to govern network expansion, structure, and the training of staff and directors
- the creation of the TSF to supply specific technical support (e.g., training and inspection) and ensure implementation of general policies

The second phase of rehabilitation, which started in 1994, is ongoing, but for the most part its objectives have already been met. The network's growth has greatly exceeded expectations. The transition from mere project status to that of an operational, autonomous network offering a wide array of credit and savings services is nearly complete.

Overview of Membership, Deposit, and Credit Services

Membership

Membership is open to all self-employed individuals who live and work in the communities that belong to a CLCAM's zone (each CLCAM serves 20 to 30 villages). Each CLCAM is free to set its own membership requirements. Most CLCAMs request that a person pay CFAF 200 (US$0.40) as an entry fee, buy at least one share worth CFAF 1,000 (US$2), and deposit a minimum of CFAF 5,000 (US$10). Three identification photos are required and cost CFAF 1,500 (US$3).

Because FECECAM was originally created to provide financial services to farmers, the primary target clientele of FECECAM was wealthy farmers growing cash crops (mainly cotton), organized within village-level farming cooperatives that guarantee the loans. However, in recent years, the membership of the CLCAMs has changed substantially. Ten CLCAMs have been created in urban areas with a total membership of 33,600 (one-fifth of the total network membership), 60 to 70 percent of whom are not farmers but traders, artisans, and retired civil servants. Also, thanks to the introduction of a program to develop women's access to credit, women's membership has been rapidly increasing.

FECECAM is therefore no longer a credit union network used exclusively for agricultural credit, as its name indicates, but increasingly a financial intermediary offering services to a diversified clientele. This brings the advantage of greater diversification of the portfolio and thus lower covariant risk. It could, however, also create certain problems:

- Different client groups have distinct and sometimes conflicting interests.
- The composition of the management structures could be affected if decisions are made to include representatives of new groups.
- The work grows increasingly complex because each client group has different demands.

Nonmember depositors

FECECAM has excluded civil servants, public and private employees, and organizations such as enterprises or NGOs from its membership because these categories are not considered to be very creditworthy. Serving their credit demands would limit the amounts of credit available for rural members. These people and organizations are nonetheless allowed to become nonmember depositors ("users") of the CLCAMs, meaning they are allowed to deposit funds but are not eligible to receive loans. Users are not charged an entry fee, and they do not hold shares.

Deposit services

At the time of the study in 1996, CLCAMs offered three types of deposit products, all of which have a minimum deposit of CFAF 5,000 (US$10):

- passbook accounts that receive an annual 3 percent interest rate[7]
- term deposits that receive an interest rate that varies from 3.5 to 4.5 percent a year according to the CLCAM
- current accounts that do not receive interest and are used mostly by NGOs or firms

[5] Institut de recherches et d'applications des méthodes de développement, Paris.

[6] Caisse française de développement: US$3.7 million; International Development Association: US$2.2 million; French, Swiss, and German governments and European Union: US$3.4 million; Government of Benin and beneficiaries: US$3.5 million.

[7] Interest is calculated every 3 months on the minimum balance held on the account during that period.

The rate of interest on deposits is low. When inflation is taken into account, real interest rates were close to zero during the years preceding the devaluation of the CFA franc in January 1994, and –5.5% in 1994 and –11.5 percent in 1995.[8]

All of these deposit products are available to members and nonmember clients alike. Passbook accounts and term deposits represent "useful deposits" since they are used for on-lending. The amount of deposits available for funding loans is currently limited to 70 percent of total outstanding deposits and will increase to 85 percent in 1997, thus remaining in compliance with the "PARMEC law" governing credit unions in the countries of the West African Economic and Monetary Union. Although in 1996 Benin was the only country in which this law had not yet been passed, FECECAM has taken all steps necessary to be in compliance with its requirements once it comes into effect.

Loan services

To obtain a loan, members must comply with the loan requirements of their CLCAM. These requirements vary from one CLCAM to the next. In general, members must have deposited savings in their CLCAM for at least 6 months before being eligible for a loan. The amount of an individual loan is based on the number of shares and the volume of savings held. However, all CLCAMs have shown some flexibility with these rules, particularly to facilitate women's access to loans.

Most CLCAMs offer four types of loans (though some CLCAMs offer fewer):

1. Short-term loans of up to 1 year that are paid in one installment at the end of the loan term (principal and interest combined). These loans are used to finance a variety of activities such as agricultural production cycles, fertilizers or seeds, trade activities, or services.
2. Under the small loan program TPCF,[9] loans ranging from CFAF 20,000 to CFAF 60,000 (US$40 to $120) are granted to women who are members of a solidarity group. Each group becomes a member and obtains a loan from the CLCAM, which is then divided among its members according to their needs. The loan term is 6 months, but some groups require weekly repayments that they deposit in the CLCAM until the loan comes to maturity. The loans are priced in accordance with the CLCAM's current rates, with no subsidy, and have the potential of becoming profitable. After having obtained two or three loans (on average) as part of a solidarity group, women are asked to become members of the CLCAM, which means depositing savings and accessing individual loans with collateral requirements.
3. Extended short-term loans were introduced in 1995 to finance commercial activities that carry inventory. They have a duration of 2 years and are paid back in regular installments every 3, 6, or 12 months. The interest rate on these loans can be slightly less than that of short-term loans (interest is calculated on a declining basis).
4. Medium-term loans have a maximum duration of 3 years and are used to finance investments in agriculture or for post-harvest processing of agricultural products. These loans have been introduced in only three of the seven CLCAM regions via lines of credit from the International Fund for Agricultural Development and the African Development Bank. They are paid back in regular installments with interest calculated on a declining basis.

Annual interest rates vary according to the product and the CLCAM, but they typically are 15 to 18 percent, with an average (nominal) rate of 16 percent in 1996. Maximum individual loan size was limited to CFAF 1 million (US$2,000) until 1996, but an increase to CFAF 2 million (US$4,000) was planned.

Loans are generally character-based, but some form of collateral is also required. This collateral can be of several types: a guarantee from a village group or from one or more persons or tangible property such as a bicycle, a plow, or real estate. Collateral is not formalized in the presence of a notary public and liens are rarely made. The conditions imposed by managers and boards of directors regarding guarantees vary among CLCAMs and depend on the degree of confidence they have in the member and the level of risk associated with his or her microenterprise. Collateral requirements are usually stricter for medium-term loans.

Results

Outreach

The second phase of rehabilitation, which started in 1994, has been characterized by tremendous growth in membership. On July 31, 1996, FECECAM had 165,600 members—more than four times its total membership in June 1992. This rapid membership growth can be explained by a restoration of confidence and a gradual loosening of credit policy. The number of members is fairly evenly distributed among the seven regional unions. Women members have increased greatly since 1993. Women make up between 37 and 50 percent of total membership (the exact percentage is unclear). By the end of 1995, equity from member shares had reached CFAF 458.6 million (US$917,000).

FECECAM has often been criticized for its low level of outreach. But in fact FECECAM's membership represents 3 percent of Benin's total population and 14 percent of the active rural population. Compared with credit programs in other countries of West Africa, FECECAM's impact on the country is significant. In West Africa, FECECAM stands out as one of the microfinance networks with the best level of outreach.

In March 1996, there were 40,800 nonmember depositors, i.e., 21 percent of all depositors,[10] down from 59 percent in 1993. This trend is beneficial to the network because the deposits of members are more stable than those of users. Users play a significant role in the 10 urban CLCAMs, which mobilized nearly 40 percent of all network deposits in July 1996.

Deposits

The growth in membership and confidence in the network have led to record levels of deposits. In July 1996, total deposits outstanding were CFAF 13.31 billion (US$26.6 million). In 1995, along with the growth in membership, the increase in savings was spectacular, rising by 34 percent in real CFA francs compared with 1994 (fig. 1).

In July 1996, passbook accounts made up 87 percent of all deposits, and term deposits accounted for only 1 percent of deposits outstanding. The remaining deposits were in the form of current accounts, primarily held by CLCAM users such as companies and NGOs.

Even with negative real rates of interest, the volume of deposits has continued to grow rapidly. This situation demonstrates that earnings on savings are indeed a minor consideration in an individual's decision to save. Depositors appear

[8] Before January 1994, US$1 = CFAF 250. After the devaluation, US$1 = CFAF 500. Inflation was 3% in 1993, 38.5% in 1994, 14.5% in 1995, and 9% in 1996.

[9] Tout Petit Crédit aux Femmes.

[10] "All depositors" means members and users combined.

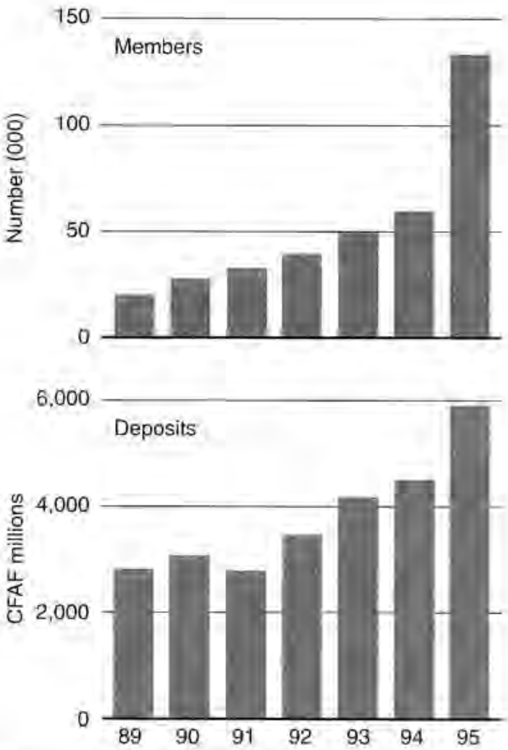

Figure 1. Growth in FECECAM membership and deposits in real 1993 CFA francs, 1989–95.

instead to be primarily motivated by the opportunity to obtain loans, the security the CLCAMs offer, and the function of insurance and advance planning that money deposited in the CLCAM fulfills. For FECECAM, deposits constitute an inexpensive source of funds. Deposits are more costly to mobilize than lines of credit, however, because they require an extensive network of local credit unions, skilled personnel, and adequate procedures.

The average volume of deposits per CLCAM in July 1996 was CFAF 214.5 million (US$430,000). The average balance per account increased only slightly between 1993 and 1995, rising from CFAF 43,650 (US$87) to CFAF 48,000 (US$96).

The deposits mobilized are insufficient to meet all requests for loans: only 50 percent of eligible loan requests are satisfied. Many savings accounts are

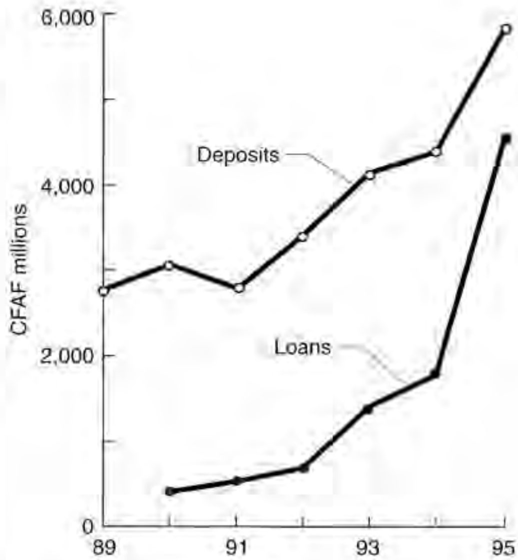

Figure 2. Growth in FECECAM's outstanding deposits and loans in real 1993 CFA francs, 1989–95.

inactive. A large number of members, especially women and traders, maintain their accounts at the minimum level needed to obtain credit.

Loans

In July 1996, outstanding loans reached CFAF 9.07 billion (US$18.1 million). The strongest growth was in 1995, as shown in figure 2. During 1995, credit policy was loosened considerably, and new credit products—such as very small loans to women—were introduced.

In July 1996, the portfolio breakdown by type of loan (amounts outstanding) was 64 percent short-term (up to 1 year), 32 percent extended short-term and medium-term (1 to 3 years), and 4 percent "very small loans to women" (TCPF). The loan portfolio is beginning to take on a diversified character, with an increase in medium-term loans.

For the whole network, the breakdown of loans by purpose is 44 percent for trade and 44 percent for agriculture, fishing and livestock combined.[11] Considering that in

Benin 71 percent of rural household income comes from nonagricultural activities, particularly trade,[12] the FECECAM loan portfolio distribution still appears favorable to agriculture. During the initial rehabilitation phase, however, agricultural loans made up the majority of the portfolio. This tends to confirm that the nature of FECECAM is changing: the network is not catering to the exclusive needs of farmers as much as in the past. To remain strongly represented in rural areas, FECECAM will need to respond to demand by increasing financing for agricultural activities, such as medium-term loans for investment.

Average outstanding loans per CLCAM totaled CFAF 146.3 million (US$292,600) in July 1996. The number of loans at that time was roughly 45,500, meaning that more than one of every four members had a loan outstanding. The average loan size was CFAF 204,000 (US$408), or equivalent to 1.1 times per capita income. FECECAM does not lend to the poorest segments of the population, in contrast to, for instance, the Grameen Bank in Bangladesh whose, average loan in 1995 was equivalent to 63 percent of per capita income (Yaron, Benjamin, and Piprek 1997). Yet FECECAM does not lend to the very rich, despite widespread pressure within the network to raise the lending limits in order to extend larger loans.

Arrears are monitored carefully and loan-loss provisions are made according to the following rules:

- When a loan is less than 3 months in arrears, it is considered delinquent but no provision is made.
- When a loan is 3 to 6 months in arrears, it is provisioned at 50 percent.
- When a loan is 6 to 9 months in arrears, provisioning is 75 percent.
- When a loan is more than 1 year in arrears, it is provisioned at 100 percent.
- Loans that are 2 years past due are written off.

Arrears appeared well under control through 1995 because of careful adherence to the rule requiring that any CLCAM failing to recover more than 90 percent of its loans cease its lending operations until the situation improved. At the end of 1995, the arrears rate was only 2.21 percent.[13] The next year, however, the quality of the portfolio deteriorated. In March 1996, nine CLCAMs (i.e., 15% of the CLCAMs) were forced to halt their lending operations. By July, the situation had worsened: 17 CLCAMs (i.e., 27% of the total number) failed to meet the 90 percent threshold, and in two CLCAMs the level of arrears rose to 20 percent. For the entire network, the arrears rate amounted to 5.4 percent of total outstanding loans. Some CLCAMs did not halt their lending activities, even after reaching the authorized limit on arrears. This situation can be partly explained by the fact that the state-owned enterprise that centralizes the purchase of cotton (Benin's main cash crop) failed to pay according to schedule, thus impeding the ability of farmers to repay their loans to the CLCAMs on time. But problems may also have contributed. One may be the challenge facing boards of directors in making sound loan decisions when they do not know the new members of the CLCAMs well. Another might lie in the difficulties of monitoring rapidly increasing loan portfolios.

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[11] Other purposes include housing 10%, and miscellaneous, 2%.

[12] UNDP/ Ministry of Rural Development, Benin.

[13] This ratio is calculated by comparing outstanding arrears, i.e., the total amount of all loans that have come due but not yet been repaid, with total outstanding loans (including loan loss reserves). Most CLCAM loans are to be repaid in a single installment of principal plus interest.

Women's Participation

Women's participation in the network increased rapidly after 1993 when TPCF, the program of very small loans to women, was introduced. In July 1996, all CLCAMs were participating in this program, resulting in a substantial increase in female membership: the TPCF program accounted for CFAF 376 million (US$752,000) in outstanding loans (4% of FECECAM loans) to 7,164 women borrowers (16% of the total number of loans). The average loan amount was CFAF 52,500 (US$105). Overall, however, in July 1996, women accounted for 45 percent of the network's total borrowers and 37 percent of the outstanding loan balances. This situation demonstrates that many women receive large individual loans after graduating from the TPCF program.

However, the rapid growth of the TPCF program has led to an increase in arrears. In July 1996, almost one of every 10 TPCF loans was past due. This is a result of failure to adequately inform TPCF groups about their roles and the loan procedures. In addition, managers and boards of directors were overwhelmed by the task of managing the loans and were unable to monitor the groups closely.

The major increase in women's participation in the CLCAMs has not yet been reflected in a commensurate change in the composition of management and paid staff. Women hold only 12 percent of the elected positions in the CLCAMs and 7 percent of those in the regional unions. They make up 11 percent of the paid staff of the CLCAMs but, in 62 CLCAMs, there are only three women managers. Such low representation does not permit ample consideration of women's concerns.

Financial Performance

All but five of the CLCAMs were profitable in 1995. However, because the CLCAMs were not paying for all the services received from the regional unions and the federation, it is important to have a closer look at the overall financial health of the network.

Financial Spread

For reasons that are not clear, the level of revenue earned on average outstanding loans (21.3% in 1995) is higher than the average lending rate of the CLCAMs (about 18% in 1995). Although FECECAM publishes consolidated financial statements for the entire network, it appears that there has been some double accounting. The cost of deposits declined from 5.7 percent of the outstanding loan portfolio in 1993 to 3.4 percent in 1995, and it is drawing close to the interest paid on passbook accounts, i.e., 3 percent. Since loans offer high yields and financial costs have been well managed, the spread on CLCAM loans has been increasing—from 12.8 percent in 1993 to 18 percent in 1995. However, the network's total spread (including investments and borrowings) declined over the same period, from 4.7 percent in 1993 to 3.3 percent in 1995.

Loan quality

The amount of loan loss reserve has declined relative to the volume of outstanding loans at year end. This ratio, which amounted to 4 percent in 1993, fell to 2.4 percent in 1994 and 2 percent in 1995, reflecting the overall good health of the loan portfolio. In 1995, the total provision amounted to CFAF 76 million (US$152,000). However, because of the deterioration in the quality of the portfolio in 1996, the level of provisions will probably increase as a result.

Operating costs

The ratios of network operating and personnel costs to average outstanding loans have declined considerably over the years:

	1993	*1994*	*1995*
Operating costs/loans	51.9%	52.0%	33.9%
Personnel costs/loans	14.2%	10.1%	8.4%

However, the operating costs ratio remains high, which means that costs have been increasing—although not as fast as the loan portfolio. In particular the costs of the regional unions and the TSF have been increasing. This is a burden on the CLCAMs, which are the only levels of the institution that generate income.

Return on Assets and Return on Equity

The return on assets, although negative, rose from –12 percent in 1993 to –5.2 percent in 1995. The return on equity followed a similar trend, but improved even more substantially as it moved from –238.4 percent in 1993 to –108.2 percent in 1995.

Reliance on Subsidies

The importance of grants as a source of revenue is declining. The ratio of grants to average outstanding loans dropped from 56.5 percent in 1993 to 17 percent in 1995. Subsidies are still required at the regional union and TSF levels, but only minimally at the CLCAM level. Although the network's dependency on subsidies has not yet been eliminated, reliance on operating subsidies has been less than anticipated for the second phase of the rehabilitation project.

Analysis of the subsidy dependency index (Yaron 1992) also demonstrates that the network is gradually reducing its dependency on subsidies. The index fell from 250.2 percent in 1993 to 127.8 percent in 1994, and to 70.4 percent in 1995. This means that, if the CLCAMs had adopted a loan interest rate of 30.7 percent (18% x 1.704), the network could have operated without subsidy. Such a rate does not seem out of line; many microfinance institutions charge annual interest rates of 30 to 40 percent or more. However, this rate would not be authorized in Benin because of its usury law, to which the PARMEC law makes explicit reference. The usury rate is equal to two times the discount rate of the West African Central Bank.[14] In early 1997, this resulted in loan rates of 12 to 18 percent.[15]

Operational Self-Sufficiency

For the FECECAM network, operational self-sufficiency is in sight. In 1993, credit revenue covered 70 percent of total costs. By 1995, operational self-sufficiency had risen to 74 percent. When noninterest revenue was included, the ratio became 81 percent in 1995.

If the network were to remain in its present state, with a 30 to 40 percent annual growth of its loan portfolio—and without a commensurate increase in costs—the network's management believes that FECECAM should be in a position to forgo all subsidies as early as 1998. However, since management and members of FECECAM have ambitious expansion plans, reliance on subsidies will still be necessary to cover the investments and operating costs associated with expansion.

Productivity

In 1995, FECECAM had a staff of 312, roughly 70 percent of whom were involved in financial transactions, and a total of 1,240 elected directors. Table 1

[14] Union economique et monétaire ouest-africaine (UEMOA).

[15] In 1997, the West African Central Bank agreed to raise the usury interest rate to 30% for all microfinance institutions, irrespective of the discount rate.

Table 1. FECECAM productivity indicators.

Year	Loans per employee (no.)	Members per employee (no.)	Loans elected director (no.)	Members elected director (no.)
1993	108	297	16	44
1994	120	340	20	57
1995	352	921	41	105

demonstrates the progress made in productivity at the level of both staff and elected directors.

Overall, FECECAM has been successful in building up the trust of its members and attracting many new ones. The growth of the network has been spectacular, and FECECAM is making substantial progress toward financial viability. An analysis of its factors of success can help understand what made the rehabilitation of the network possible.

Factors of Success

Commitment of Members, Directors, and Staff

Rehabilitation of the CLCAM and CRCAM network was made possible thanks to the network's main participants—its elected directors and members—who have fully committed themselves to the goal of saving the institution. They are highly motivated and productive, spending long hours on the job. They are also proud of the results achieved, and optimistic about the network's future.

Paid staff have also played a critical role in the rehabilitation effort. In 1989, most CNCA staff members consented, without much resistance, to becoming the employees of farmers who hold elected positions, even though the latter are often illiterate and usually less educated than their employees.

Staff are highly motivated and accessible to clients, particularly in the CLCAMs, despite their modest salaries (during the rehabilitation effort, salaries were decreased substantially). With equivalent education and responsibilities, they could expect compensation five to eight times higher in a private bank or certain NGOs. This happens to be a weakness in the network: numerous staff members have recently left their jobs and many continue to leave. Unless salaries are made competitive with those in comparable institutions, there is a risk of a major loss of managers and employees over the coming years. In addition, such low salary levels could induce some paid staff to turn to embezzlement and fraud.

Indeed, the staff show signs of fatigue and dwindling motivation. The board of directors of FECECAM has been slow in nominating a replacement for the executive secretary (general manager) for the network who resigned in February 1996. As a result, the management team does not feel supported and guided in its work, and the effects of this are visible throughout the network.

A New Model of Credit Unions

The success of FECECAM can also be attributed to its ability to transcend the classic credit union model by introducing innovations and flexibility. First, most credit unions focus primarily on savings mobilization and tend to be risk-averse when it comes to loan disbursement. In contrast, in FECECAM, the culture of savings is not dominant, and prudence in transforming deposits into loans is not excessive. FECECAM has offered timely responses to its members' pressing demands for financing by rapidly increasing the percentage of deposits outstanding available for on-lending, and by developing attractive credit products.

Second, unlike many credit union networks, FECECAM's target clientele is not exclusively composed of men, the heads of farms in cash crop-producing regions who have a high savings potential. More women are becoming members, thus introducing a measure of gender balance.

Third, uniformity of procedures and rules is not imposed, and decisions and resources are not centralized. FECECAM has succeeded in introducing flexibility by encouraging entrepreneurial and innovative behavior in its operations. Each CLCAM sets its own credit policies and is free to test new approaches and products.

Fourth, FECECAM has been able to develop into an original and unique network that takes into account local situations and concerns. Part of this achievement is rooted in FECECAM's lack of affiliation with foreign credit union networks such as Crédit Mutuel (France), Développement International Desjardins (Canada), or World Council of Credit Unions (USA).

Fifth, in West Africa, FECECAM is probably the credit union network that comes closest to achieving technical and financial autonomy, since it relies little on foreign technical assistance and has so far managed to control its growth.

Finally, to a large extent, the network has also managed to resist outside pressures much better than many credit union networks. FECECAM never agreed to lower interest rates to the levels sought by the government, because to do so would have prevented the network from reaching financial self-sufficiency. FECECAM resisted the temptation to accept too many subsidized lines of credit from donors. It realized the dangers of this approach: the risk of decreased savings efforts by members in the wake of a capital infusion, constraints associated with individual donors' specific requirements, and the foreign exchange risk on lines of credit.

Internal Controls

Another area of success of the FECECAM network is the quality of its internal controls, which has enabled the network to keep the level of embezzlement and fraud close to zero. First, boards of supervisors play a fundamental role in monitoring the operations. At each of the three levels of the organization, they oversee both the work of paid staff and that of elected directors. In addition, the five-point chain of control set up in 1993–94 increases the level of surveillance and helps guarantee that accounts and financial records are reliable and complete.

The five points of control are the local accountants (one accountant for one to three CLCAMs), the chief accountant of each regional union, the internal controller of each regional union, the internal controllers of FECECAM, and the external auditors. Another guarantee is provided by the procedures governing the physical and financial security of the CLCAMs. For example, the authorized level of cash on hand is determined according to the volume of financial assets of each CLCAM.

Areas for Improvement

Although FECECAM has made good progress in establishing an efficient institutional structure, with a high degree of ownership on the part of the members, there remain several areas in which FECECAM can improve its operations.

Access

Each of the 62 CLCAMs serves 20 to 30 villages, some of which are located as far as 60 kilometers from the CLCAM office. Such a distance implies that the poorest and most isolated villagers cannot make use of the CLCAM, and many of these villagers perceive the CLCAM as offering services only to the rich, the urban, and the literate.

To serve the most disadvantaged segments of the population, mechanisms to make the CLCAMs more accessible might be tried. Education and information are useful tools in this regard, but often they are not sufficient to put people at ease and, as a result, social intermediation may also be required. One method of social intermediation consists of working with groups (either existing groups, such as savings and credit associations that are common in villages, or newly created ones) to further their training and education. In many cases, participation in a group that offers moral support, a source of information and education, and financial guarantees is an effective way to reach the comfort level required for participating in the financial system. The CLCAMs have used this approach with success in the TPCF program.

In addition to splitting up CLCAMs holding more than CFAF 200 million (US$400,000) in deposits, one approach to the challenge of improving the network's accessibility has been to create CVECs,[16] village savings and loan banks. CVECs are grassroots associations managed by volunteer local community members. Eight CVECs had been created by July 1996, and FECECAM managers and elected directors hope to create 136 CVECs by the year 2001, as well as add an additional 43 CLCAMs. The CVECs' degree of financial professionalism is not as high as in CLCAMs, and they therefore may not be capable of meeting the same standards as the CLCAMs.

In short, CVECs represent an entirely different model and thus may not represent the best approach for increasing outreach. To insist that they do so could significantly complicate internal controls and overall cohesion. In addition, the task of managing highly decentralized village banks is almost a separate profession, for which FECECAM probably lacks the necessary know-how and skills. Increasing and diversifying FECECAM's membership could also cause upheaval within the existing governance structure, since the composition of the elected boards would need to reflect the new membership. Other avenues for increasing outreach should be explored, for example the possibility of decentralizing FECECAM services (mobile bankers, periodic facilities) without decentralizing its structures.

FECECAM is today faced with a challenge: to continue growing—while meeting the demands of both new and old members—without losing sight of the network's cost-effectiveness. To avoid the pitfalls of too-rapid progress, the institution must be prepared to develop tools and procedures consistent with its growth. This is all the more important because of the changing nature of the network. Membership is becoming more diverse, as are the products. Hence, increasing the need for rigor and closer financial management.

Management Information Systems

FECECAM has managed its growth by setting up effective accounting procedures and management information systems (MIS). This has enabled the network to avoid the crises and failures that often affect networks in the stage of rapid growth. Such problems include increases in arrears, fraud and embezzlement, and accounting errors that create discrepancies. For FECECAM to avoid these problems in the future, however, improvements in the current MIS need to be made.

For nearly 4 years (1993–96), a foreign technical assistant served as financial comptroller for the network. He made good use of his banking experience to help FECECAM prepare its chart of accounts, develop manuals of procedures for managers and accountants, and proceed with computerization of the CLCAMs. These tools have enabled the network to streamline its management. However, certain instruments—for example the 1996 UEMOA[17] banking chart of accounts, which includes 1,000 accounts—appear complex and, at times, unmanageable for the accountants.

Computerization of the network began in 1993. In October 1996, the seven regional unions and 12 CLCAMs had been computerized. Computerization of 26 additional CLCAMs was planned by the end of 1996, with 14 to 21 more CLCAMs to be computerized each year starting in 1997. Computerization was undertaken to save time, increase staff productivity, reduce the number of documents produced, and ensure the reliability of the accounts. It is estimated that in roughly 2 years, each CLCAM should be able to cover the cost of their computer equipment through the savings generated. The management software, Infocoopec, was selected because of its low cost, its popularity among numerous credit networks, and the availability of its designer in a nearby country (Togo). A software program for processing financial statements (SITE) was developed by the network. This program makes it possible to monitor budget implementation and other important indicators with performance charts.

Infocoopec appears to have reached its limits, however, and new software is needed. In October 1996, a consulting information technology firm recommended that the network develop an internal software program and recruit a person capable of creating an interface covering all problems associated with operations, internal accounting, and computerization. This would allow the various departments of FECECAM to ensure that their activities are consistent with their responsibilities.

FECECAM would also need to improve the way it monitors performance indicators. Staff and elected directors have not yet seen the importance of monitoring various indicators as a means to inform their members on the performance of their CLCAM and to improve the outreach and overall performance of the network. Only a handful of indicators are now being monitored—albeit not on a regular basis—and the TSF has difficulties in producing accurate reports because of inconsistencies in the data received from CLCAMs and regional unions. A consulting firm has been helping the network to improve in this area, and the operations division of the TSF is encouraging staff and elected directors to produce and analyze statistics and make good use of the results.

Technical and Financial Sustainability

In the future, FECECAM will be managing rapidly increasing volumes of deposits and larger loan portfolios and will therefore be faced with risks that become progressively more difficult to manage. Computerization, in particular, introduces new types of risks, and new procedures must quickly be set in place to limit opportunities for wrongdoing. In addition, various questions arise as a result of the departure of the foreign technical assistant in late 1996 and the lack of a replacement: Was the transfer of knowledge to the Beninese team thorough, even though a counterpart was never designated? Has the team mastered the new technological tools well enough to be in a position to modify and refine them? In this respect there are lingering doubts. The need to strengthen the technical capacities of FECECAM staff must be addressed by improved training. If this is not done

[16] Caisses villageoises d'épargne et de crédit.

[17] Union economique et monétaire ouest-africaine.

quickly, the network may have difficulties in becoming technically self-sustaining, meaning that it will always have to rely on external sources of expertise.

Even though financial self-sufficiency is theoretically possible, the mechanisms for achieving this status are not yet in place. The CLCAMs are the network's revenue-generating entities, but currently they hardly contribute to the operating costs of the regional unions and the TSF. These units have been providing their services free of charge instead of gradually asking the CLCAMs to pay for them. Decisions have been made within the network to start charging for services provided by the regional unions to the CLCAMs in 1997 and, for the TSF, in 1999. Thus, the CLCAMs will be asked to make a major contribution to the financial health of the network in coming years. The transition may seem a bit harsh to some of the elected directors or members, who will notice a substantial increase in the costs of their CLCAM.

Governance

Human resources management is one of FECECAM's weak spots, as is true in most credit union networks. Power struggles between elected directors and paid staff are frequent. Elected directors are occasionally stripped of their functions by paid staff. But the opposite scenario, where elected directors overstep their roles and interfere in the daily management of the CLCAMs, is not a rare occurrence either. It is always difficult to have elected farmers and CLCAM employees working together in harmony.

The articles of association and bylaws provide an explicit breakdown of the respective responsibilities of elected directors and paid staff, but not all hypothetical situations are covered. The gray areas are numerous, and quickly become sources of conflict. Some employees are reluctant to act on their own initiative for fear that they will be criticized by elected directors. Some elected directors insist that they be kept informed about the slightest details of everything the paid staff is doing. The balance is delicate and generally depends on the personality of the individuals and their communication skills.

As the network grows more complex, relations between elected directors and staff may become increasingly difficult. On the one hand, if elected directors seek to strengthen their technical capacities, they run the risk of cutting themselves off from the grassroots and no longer being in a position to represent local interests effectively. In addition, if they become more professional, they may be more reluctant to accept their volunteer status. In FECECAM, as in most credit union networks, the issue of compensation for elected directors is of acute concern, sometimes causing major conflict. Moreover, if the rules regarding turnover in elected positions are not rigorously enforced, then problems may arise if the directors view their positions as permanent. The more "professional" the elected directors become, the more they will find themselves in competition with the paid staff. The latter may feel threatened or judged, resulting in a sharp decline in motivation and perhaps leading to their departure. On the other hand, professionalism of the paid staff is necessary, yet it can contribute to increasing their technical authority and lead them to make choices that are not consistent with the priorities and interests of members.

To ensure the harmonious development of FECECAM, all actors in the network must strive to respect the balance of forces between elected directors and paid staff. One solution identified by the network for ensuring that the dialogue between elected directors and paid staff remains cordial and constructive was to organize management audits on an annual basis. Two consultants visit all the regional unions and a selected number of CLCAMs and listen carefully to elected directors and members. Together they identify problems and reflect on possible solutions. Each mission includes a major effort to set up or improve decision-making and work procedures. These missions are financed by donors.

FECECAM has many serious issues to grapple with, of which the most difficult may be managing growth. The key question is, how can they increase access to credit while at the same time improving MIS and lessening the tensions between paid staff and elected directors? The way FECECAM deals with this challenge will be watched closely by institutions in Benin and elsewhere who understand that there are some important lessons to be drawn from this experience.

FECECAM in Relation to Other Providers of Financial Services

The CLCAMs play a major role in financing local development. However, their participation in local development efforts is uneven. CLCAMs have not been active in establishing links with village-level savings and loans associations or with NGOs working in community development (which sometimes offer financial services to the communities). Nonetheless, FECECAM contributes substantially to financing activities in the rural areas of Benin and, accordingly, maintains close relations with the agricultural sector and partners at the local level. In the cotton-producing regions, producer organizations continue to play an important role in organizing the CLCAMs. In many cases, producer unions at the sub-prefecture level have been instrumental in setting up the CLCAMs. The village-level producer groups are CLCAM members and actively participate in analyzing requests for agricultural loans and providing guarantees for such loans. Occasionally, the involvement of the producer unions becomes very important, even to the point of contributing to the construction of new buildings for the CLCAMs.

FECECAM has never engaged in an institutional or partnership dialogue with the banking sector. However, FECECAM's increasing market share has made its position noticeable. Deposits collected by FECECAM represent 7.9 percent of all deposits collected in Benin. Its loans represent 16 percent of the total loans granted in the country. The average amount of deposits it uses for on-lending (68% in July 1996) is more than double the national average for commercial banks. In comparison with other banks, FECECAM appears to be the financial institution that takes the most risks.

It is interesting to note that commercial banks do not view FECECAM as a competitor. They see FECECAM as operating in such a different market from theirs that they are rather indifferent to the network's growth. This situation is bound to change. By establishing CLCAMs in urban locations, the CLCAMs are likely to draw a clientele of small and medium savers who were formerly clients of the commercial banks.

Microfinance in Benin is a dynamic field with about 60 highly innovative microfinance institutions. FECECAM holds a key position in this area of opportunity—it is the sole network that maintains a presence throughout the country. It also has the largest membership. At the national level, competition is virtually nonexistent, since no other microfinance network holds a comparable position.

Some competition—though weak—does exist at the local level. This lack of competition is not necessarily beneficial, since a natural tendency toward complacency could develop at various levels of FECECAM, thus diminishing the drive to constantly improve the network's products and operations.

FECECAM can be described as the backbone of microfinance to which other institutions can be linked in order to expand the network's impact. For this to occur, the CLCAMs must develop commercial strategies and understand the potential advantages of working with NGOs and informal organizations to reach a new clientele. However, various prejudices still hinder communication between the CLCAMs and organizations working with the poorest segments of the population.

There are several areas of collaboration with other microfinance institutions and NGOs that could be explored: (1) developing complementarity with networks and organizations that have a stronger local presence than FECECAM, (2) contracting out the decentralization of FECECAM to partners capable of supporting the creation of village-level financial organizations, and (3) collaborating with NGOs capable of providing social intermediation in the villages and neighborhoods where financial services are most inaccessible.

Internationally, FECECAM is known as the largest and best performing network of savings and loan cooperatives in francophone Africa. Its successful rehabilitation is cited more and more frequently as a model. Many credit union networks have their eyes on FECECAM and hope to benefit from the lessons of its rehabilitation process. For this reason, FECECAM has an important role to play in sharing its experience with other organizations involved in microfinance.

To maintain its good reputation, FECECAM must pursue sustained growth and to this end, the medium-term development plan makes a certain number of proposals.

Strategic Choices

The medium term development plan for 1997 to 2001 (MTDP) is the result of a participatory process carried out in 1996 at all levels of the institution to ensure a maximum contribution from all actors in the network. As such it is indicative of the network's maturity and its capacity to anticipate and provide for the future.

MTDP lays out two challenges for the network: (1) to maintain its leadership position in rural finance by reaching more clients and improving service delivery "to an outstanding degree," and (2) to maintain its primary emphasis on mobilizing savings while relying on outside lines of credit as supplemental resources. The twin objectives are "to increase the network's capacity to meet its clients' needs for financing in order to improve their living conditions (local development objective) as well as the financial profitability of each CLCAM and the entire network (banking objective)."

The MTDP develops sector policies and objectives in six areas: grassroots management; commercial matters; computerization and investment; financial, budgetary, and security matters; external relations; and human resources development and network organization. The targets FECECAM has set for 2001 to increase its effectiveness are compared with the situation in 1996 in table 2.

The projected growth in membership and total volume of deposits and loans in MTDP appears rather ambitious, but several considerations suggest that they can be achieved. First, the projections are based on growth projections for each CLCAM, and thus they take into account

Table 2. FECECAM growth targets.

Target	1996	2001
CLCAMs	62	107
CVECs (village banks)	8	144
Members	166,000	515,000
Depositors	200,000	1,000,000
Outstanding deposits	CFAF 13.31 billion (US$26.6 million)	CFAF 43 billion (US$86 million)
Outstanding loans	CFAF 9 billion (US$18 million)	CFAF 36.5 billion (US$73 million)
Medium term loans	15%	40%
Borrowers	44,445	274,658
Permanent staff	312	581
External debt	CFAF 4.1 billion (US$8.2 million)	CFAF 7.8 billion (US$15.6 million)
Operating income	CFAF 429.4 million (US$858,000) (1995)	CFAF 1.039 billion (US$2.1 million)

the specific growth potential of each facility. Second, the network has consistently exceeded more conservative projections made in the past. Such a high level of enthusiasm for financial services and confidence in the network was never foreseen, for instance. There is still significant unmet demand for high-quality financial services in Benin, and as a result the network continues to enjoy excellent growth potential. Third, the MTDP demonstrates that participants in the network are aware of FECECAM's weaknesses and take them into account in their analysis and projections.

The success of the MTDP will largely depend on the success of the human resources development plan. It is of critical importance that new members and employees share the institution's values. It is also important that paid staff and elected directors be motivated, from both a financial and human standpoint, to contribute to the network's success (and that they work together in harmony). The difficult balance between grassroots management and financial management will need to be maintained, and the autonomy of the network protected.

The network's success will also depend on its capacity to maintain its autonomy. Meeting the objectives of the MTDP will require large subsidies from donors (either direct grants or subsidized lines of credit), ranging from CFAF 10 million to CFAF 25 million (US$20,000 to $50,000). The directors may not fully appreciate the scope of potential conditions imposed by donors and their objectives, because what is good for the donors is not always what is best for the network. Subsidies do not encourage the network to improve its performance, streamline its costs, and develop modern, competitive tools for financial intermediation.

Conclusion

FECECAM has embraced an ambitious goal: to achieve major growth, which requires developing its professionalism, while maintaining a clear identity as a credit union network. This is clearly a challenge since, in most cooperatives throughout the world, the grassroots identity tends to decrease as growth takes place and professionals play a greater role. But professionalism is synonymous with improved performance—cost reductions, the development of products of better quality, and growth in clientele. These improvements should benefit the greatest possible number of members. For this reason, professionalism must not be perceived as working "against" elected directors and members but rather as working "for" them.

The challenge for FECECAM will be to reconcile the objectives of outreach with the network's technical capabilities and its desire to achieve financial viability. The projected growth will indeed be challenging and expensive, since it entails creating numerous decentralized units and raising the level of professionalism (through training and computerization). It will require donor support insofar as FECECAM's own resources will be insufficient. The goal of attaining financial autonomy may thus be deferred. Like many other institutions around the world, FECECAM finds itself in a situation where the desire to extend financial services to a large number of people presents the risk of jeopardizing its current success.

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NIGER

Caisses Populaires d'Epargne et de Crédit

Korotoumou Ouattara, Mayada Baydas, and Julia Paxton

CPEC, the Caisses populaires d'épargne et de crédit, a network of credit unions in Niger, represents a unique and insightful approach to microfinance. The experience of the CPEC movement since it was founded in 1990 provides useful lessons on several fronts for practitioners of microfinance. The CPEC movement is an example of building, from the ground up, a credit union that targets lower-middle and low-income groups. In the short history of the CPEC movement, one of the principal developments has been a phenomenal interest in savings among members, exemplified by the unanticipated growth in deposits. In addition, the CPEC movement case demonstrates how financial services can be provided despite political and economic instability, an underdeveloped regulatory environment, poverty, illiteracy, and uncertain external funding sources.

This case study presents the situation of the CPEC network at the time of an evaluation performed by a team from the Ohio State University (USA) in 1995. Additional data obtained in April 1998 provided the basis for an update.

Country Context

Niger presents a most challenging environment for the provision of sustainable financial services. Perhaps foremost is the low income level of the population, which results in a demand for microfinancial services. In 1995 Niger's GNP per capita was only US$220. Rural inhabitants suffer marked income fluctuations as a result of frequent droughts. In addition, the population density is very low, making it difficult to reach rural people with financial services. Social indicators also are unfavorable. The 1994 life expectancy was only 46 years, and the adult illiteracy rate, 86 percent, is the highest in the world (World Bank 1996).

In recent decades, economic and political strife in Niger has led to financial uncertainty. In the 1980s, the instability of the financial landscape resulted in the bankruptcy of many banks. The few remaining commercial banks had a high urban bias. A study of the financial system conducted by an Ohio State University research team in 1986–87 found that there were no formal financial institutions outside the main urban areas of Niger such as Niamey (Cuevas 1992). Rural households had to rely almost exclusively on informal financial intermediaries for financial services.

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Project Origins and Objectives

Around the world, the 1980s witnessed a surge of targeted group financing by NGOs and self-help groups. Usually, these programs were sponsored and funded by donors and were not regulated by central bank authorities. Although many of these programs had success in reaching the very poor, their scale remained small, and they relied heavily on donor funds. In reaction to these shortcomings, a "new view of microenterprise finance" (Otero and Rhyne 1994) that emphasized a financial-sector and market-oriented approach gained prominence by 1990. Part of this new view focused on institution building. Rather than merely providing financial services to a target group regardless of efficiency, institution-building efforts tried to create and strengthen financial institutions that would be able to serve the relevant target group through sustainable banking practices (Schmidt and Zeitinger 1994).

Donor institutions became increasingly interested in supporting institution-building efforts in microfinance by the early 1990s. The credit union model promoted by the World Council of Credit Unions (WOCCU) fit neatly into the new view of microfinance in that it emphasized financial sustainability, local participation, and a variety of financial services including both lending and savings. Securing funding from the U.S. Agency for International Development (USAID) for the development of a credit union network in Niger gave WOCCU a unique opportunity to build a financial institution from the ground up.

WOCCU project leaders were excited by the prospect of avoiding traditional pitfalls associated with credit unions by creating a strong institution based on financial principles, clear guidelines, and appropriate incentives. The CPECs tried to avoid some of the bad habits found in well-established credit union movements in Africa. For example, in some African countries credit unions have been immobilized by a rigid interest rate structure that does not reflect the market. In Cameroon, low monthly interest rates favoring borrowers have become so ingrained that it is difficult to change them. Another problem in many African credit unions is that the leadership becomes entrenched, and those on the board of directors have special privileges including preferential access to loans. The CPEC movement tried to avoid these pitfalls by creating a board that determines market-oriented interest rates and by offering incentives (such as paying managers a salary and contributing to building construction and maintenance costs) to those credit unions that are successfully managed and performing well according to regular evaluations.

Rather than creating market demand for financial services, the founders of the CPECs sought to meet market demand by tailoring sound financial services. Because individuals seek security and liquidity in an uncertain environment, deposits are one of the most valued services in Niger. As such, the objective of the CPEC movement has been "to grant the population of Niger, in both urban and rural areas, access to financial services through the creation of a new network of sustainable financial institutions that is based on the mobilization of local savings" (WOCCU 1996).

Institutional History and Structure

The CPEC movement in Niger was started as a pilot project in the department of Zinder through a cooperative agreement between WOCCU and USAID in 1990. During the pilot phase, which lasted 3-1/2 years, credit unions were developed and promoted in the Zinder department.

Eleven CPECs were created.

During the second phase of the project (1992–97), the objective was to promote and extend CPEC development in other departments, to promote new CPECs, and to provide support services to them. From 1993 to 1995, project growth surpassed targets by 150 percent, resulting in concerns for growth management. Therefore, from 1995 to present, the institutional focus has been directed at better control and safety.

In January 1996, a coup d'état hastened the withdrawal of USAID from Niger. The departure of USAID has left the CPEC movement without external funding for capacity building as it strives to remain viable in an unstable economic and political environment. Since then, the movement has remained fragile, and several of the weakest CPECs have been liquidated. Nevertheless, many of the CPECs have a solid foundation, and the project founders hope that this nascent movement can continue on a path toward sustainability.

CPECs in Niger function according to the basic democratic operating principles set out by WOCCU for all its affiliated credit union organizations. Under the credit union structure, members are the owners, and cooperation and social responsibility are key operating principles. CPECs are member-owned, member-operated, nonprofit organizations that function as cooperative financial organizations. Managers are responsible for day-to-day decisions, while the ultimate control of the organization belongs to the general assembly of member-owners. The CPEC governance structure is characterized by a one-person, one-vote rule, implying that voting powers cannot be accumulated by any individual.

Membership in the Niger CPECs is open to all community members. The majority of the CPECs are open-bond credit unions (members are from the same community, village, or residence area), but a few occupational or closed-bond CPECs exist in urban areas (members are in the same profession, occupation, or business). The membership fee includes a minimum deposit of CFAF 500 (US$1)[1], which buys the member a share. An individual's share capital cannot be traded or sold to others outside the CPEC. The member gets restitution of his or her shares upon resignation from the institution. Niger CPECs mobilize savings and provide loans to their members exclusively.

Each CPEC is run by a management committee of 11 members (on average) and one salaried manager. The committee comprises a board of directors, a credit committee, a loan monitoring committee, and a training and marketing committee. The cashier or general manager is the only paid employee. The credit committee analyzes all loan requests and makes the final decision. Large loan requests (CFAF 200,000 or more) are submitted to the board of directors for final approval. In CPECs that have mixed (male and female) membership, one-third of management committee members, on average, are women. A board of directors representing all of the CPECs has been created in recent years to monitor the overall growth and viability of the CPECs and to begin the slow process of turning the movement into a credit union federation.

Loan and Savings Products

Loan Products

General credit policies are similar in all CPECs (and more stringent during the

[1] The devaluation of January 1994 changed the average value of the CFA franc from 250 to the U.S. dollar to 500 to the dollar.

first year in which the institution engages in credit activities):

- A minimum deposit of CFAF 5,000 is required to apply for a loan.
- At least 3 months of membership is required before a loan can be applied for.
- A member has a right to a loan equivalent to a multiple of his or her deposit (frequently 2:1).
- A cosigner who is also a member is required for any loan and must have sufficient funds in his or her savings account to cover the entire amount of the loan.

After a year of activity, CPECs may revise their loan policies. Thus, loan multiples may change from 2:1 to 3:1. Most CPECs also find the cosigner requirement too restrictive and have revised their loan policies to include accepting tangible collateral. In rare cases, group loans are available at the request of the institutional members. Loan characteristics are fairly similar across CPECs:

- Average loan size: US$220
- Nominal interest rate: 2 percent per month
- Effective annual interest rate: 48 to 54 percent
- Average term: 5 months

There are no limitations on loan use. Consumption purposes include naming ceremonies, weddings, health care, funerals, and school fees. Production purposes include buying seed, buying inputs, and cattle rearing.

Savings Products

Individual members as well as groups can open a savings account at the CPEC. The average savings account held about US$35 in 1996. Until 1995, there was only one savings product available—a current deposit account that earned no interest. However, members were rewarded at year-end when profits were redistributed, and each member received a dividend proportional to the amount of savings. Members did not seem to mind the lack of interest on deposit accounts because most view the CPEC primarily as a safe place to save. However since 1995, interest-bearing savings accounts have been available. The management recognizes the importance of remunerating savings and has been working to develop new term-deposit accounts to attract potential net savers, especially women.

Client Profile

The CPECs serve a predominantly male clientele. Women constitute 33 percent of the CPEC membership and receive one-third of all loans granted. However, women's average loans are about half the size of men's. Women usually request smaller loans because the activities they engage in require smaller investments. Approximately 85 percent of the members reside in rural areas, although the CPECs are expanding in urban areas. Illiteracy remains a problem for the credit unions, even though the literacy rate for members (45%) is well above the national average (14%).

The objective of the CPEC is to reach low-income and lower-middle income clients in rural and urban areas, but no specific guidelines exist regarding client characteristics. A survey completed in 1995 provides data on the CPEC members in rural areas and in Niamey.[2] Survey results reveal that a typical rural CPEC member is a male farmer or microentrepreneur, head of household, in his forties, with an average annual income of CFAF 756,356 (US$1,512) in Zinder and CFAF 1.8 million (US$3,600) in Maradi, which is a very active trading region. The CPECs are the most important financial source for those interviewed, but the informal sector is also an important source of credit for many of the rural members.

The results of the Niamey survey indicate that only a small number of the entrepreneurs in the manufacturing sector are CPEC members. The entrepreneurs reported using mostly informal sources of financing. Nearly all entrepreneurs (96%) reported that they use retained earnings as a source of financing their current operations. In addition, informal credit and supplier credit were common financing tools. Only 13 percent of the interviewed entrepreneurs have acquired formal finance from a commercial bank or a CPEC for the purpose of operating their businesses. Among the most common savings channels are the commercial banks, CPECs, *tontines*,[3] and money keepers. However, owing to the recent political and economic instability, fewer people feel confident about placing their savings in commercial banks. The large array of financial services used by micro- and small-scale entrepreneurs in Niamey indicates that there is room for the CPECs to attract many manufacturing enterprises into their pool of clientele as they expand in urban areas.

Performance

The performance of the Niger CPEC movement has been remarkable in general. The most notable result of the nascent credit union movement has been the strong interest and rapid growth in savings mobilization. This demonstrates the ability of a low-income clientele to save, but it also has presented problems associated with rapid growth including liquidity management and high arrears. Overall program indicators demonstrate favorable trends related to sustainability and efficiency. However, the political and economic changes in 1996 have led to a worrisome deterioration several indicators.

Scale and Depth of Outreach

Since 1989, the development of the CPEC movement has surpassed all expectations. The most rapid growth occurred from 1990 to 1995. By December 1995, 64 credit unions had been created with 10,725 members, or an average of 167 members per credit union. As a result of the fast expansion and the political and economic uncertainty in the country, network management deliberately slowed growth after 1995 to focus more on financial sustainability, sound banking practices, and managed growth. The National Forum of CPECs plans to reduce the network by liquidating some poorly managed credit unions and merging smaller ones with stronger, healthier credit unions.

The CPEC movement in Niger is undoubtedly reaching many poor clients. Most CPECs are located in rural areas, and CPEC clients in Zinder and Maradi departments are mostly farmers or micro-entrepreneurs. The ratio of average loan size (US$220) to GDP per capita is 88 percent, showing that the target population remains the economically active poor.

Figure 1 illustrates the characteristics of the clients of the CPEC movement in comparison with the country average. The outreach diamond illustrates four categories of banking clients that are often favored: males, urban inhabitants, the wealthy, and the literate. Figure 1 shows that, compared with the country average, more of the CPEC clients are men, and the CPEC clients are more literate. The income

[2] The client survey was conducted by Korotoumou Ouattara and Mayada Baydas in the departments of Zinder and Maradi and included 720 individuals, half of whom were CPEC members. In Niamey, 159 urban enterprises were surveyed.

[3] An informal group known as a ROSCA (rotating savings and credit association).

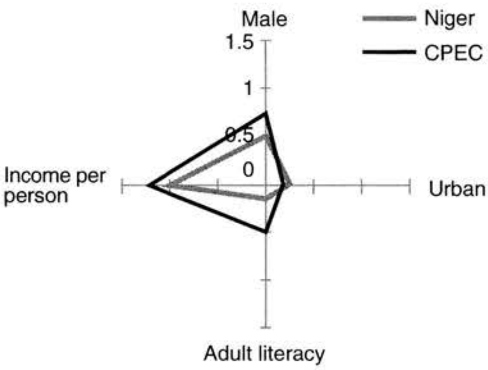

Figure 1. CPEC depth-of-outreach diamond.

of the CPEC member is similar to the country average. Also, the CPECs have had great success in reaching rural clients, a group that has long been overlooked by formal finance.

Loan Portfolio

Scale and Growth

Table 1 illustrates the rapid expansion of the loan portfolio from 1993 (when the CPECs began granting loans) to 1996. Early growth of the loan portfolio ex-ceeded projections as a result of the unexpectedly fast growth of deposits. However, the political and economic uncertainty of 1996, coupled with a conscious effort on the part of management to control growth led to a slight decline in outstanding loan portfolio in real terms by December 1996.

Portfolio Quality

Although the CPECs eventually collect repayment on nearly 100 percent of the outstanding loans, slow repayment is a key concern for program survival. By the end of 1996, the outstanding loan portfolio had reached CFAF 129 million (US$252,587), but arrears rates were increasing (table 2).[4] After only 4 years of loan activities, 34 percent of the outstanding loan portfolio was in arrears. In previous years, most of the arrears were marginally late (1 to 2 months) and eventually repaid. However, by the end of 1996, the composition of the arrears shifted from marginally late payments of 1 to 2 months to 2 to 12 months arrears. In part the high arrears rate may be associated with the rapid growth of the institution when screening, evaluation, and monitoring of loans may have been weakened by the relatively abundant availability of funds. This alarming trend should be taken very seriously and monitored carefully by program managers as they strive for financial viability.

Table 1. Real growth in Niger CPECs outstanding loan portfolio (1993–96).

	Loans outstanding		Real growth
Date	no.	CFAF 000[a]	(%)
12/93	68	2,264	–
12/94	430	36,271	1,502
12/95	1,185	102,994	184
12/96	1,144	93,666	–9

a/ Real 1990 prices.

Deposit Mobilization

The growth of assets, deposits, and shares has been remarkable throughout the brief history of the CPECs (table 3). The greatest increase occurred from 1992 through 1994. Growth in the volume of deposits has been the most noteworthy, averaging 150 percent annually from

Table 2. CPEC portfolio quality, 1993–96.

			Arrears (%)			
	Loans outstanding		1–2	2–6	6–12	Over 12
Date	no.	CFAF 000	months	months	months	months
12/93	68	1,970	19.5	10.1	4.9	0.0
12/94	430	42,945	22.6	5.3	0.0	0.0
12/95	1,185	134,819	17.2	9.9	0.8	0.1
12/96	1,144	129,072	5.3	15.3	10.1	3.6

Table 3. Real growth in CPEC assets, deposits, and shares, 1990–96.

Date	Assets[a] (CFAF 000)	Deposits[a] (CFAF 000)	Shares[a] (CFAF 000)	Growth (%) Assets	Deposits	Shares
12/90	2,737	1,052	517	–	–	–
12/91	4,467	2,590	601	63	146	16
12/92	13,404	8,117	1,456	200	214	142
12/93	31,943	20,063	3,030	138	147	108
12/94	110,032	74,669	4,926	244	272	63
12/95	213,818	157,923	9,179	94	112	86
12/96	259,500	183,704	10,195	21	16	11

a\ Real 1990 prices.

Table 4. CPEC sustainability measures (%).

Year	Operational self-sufficiency	Financial self-sufficiency	Return on assets	Return on equity	Subsidy dependence index
1993	139	95	7.0	21	n.a.
1994	106	70	5.2	19	146
1995	120	93	8.6	36	53
1996	134	133	8.6	37	12

1990 to 1996. The interest in savings mobilization among members is among the most important lessons of the CPEC movement. Many credit-first microfinance institutions justify their emphasis on credit rather than on savings by stating that low-income people in developing countries are too poor to save. The experience of the CPECs in Niger has proven the opposite. Not only are the members interested, willing, and eager to save, but the savings instruments are more popular than loans. Many clients choose to save without ever applying for a loan. As a result, the credit union movement in Niger has run into problems of excess liquidity and the safekeeping of funds.

Sustainability

Key Indicators

The CPEC network has made continual progress toward sustainability despite setbacks such as the 1994 devaluation of the CFAF, the 1996 coup d'état, and the departure of USAID. By 1996, the CPECs had achieved operational and financial self-sufficiency,[5] with the highest levels of return on assets and return on equity (table 4). These sustainability measures are much more favorable than those recorded in the early 1990s when the operation was initiated. The increased levels of sustainability are the result of the economies of scale reached as the program expanded, increased mobilization of internal funds, and attention to cost effectiveness. Nevertheless, the CPEC operations have been subsidized through 1996 (at a decreasing rate), and the financial sustainability of the program in coming years will depend largely on internal management, repayment rates, and solvency of the CPEC network.

Subsidy Dependence

The objective of the subsidy dependence index (SDI) is to provide a comprehensive method of assessing the overall

[4] While no portfolio-at-risk (PAR) indicator is available, one can assume that the PAR figure is very high for the CPEC movement since the PAR measure takes into account the outstanding balance of all loans in arrears, not only the installments past due.

[5] These sustainability measures were calculated from the CPEC financial statements and do not include all WOCCU costs associated with training and technical assistance. Were these costs to be included, the financial sustainability measures of the CPECs would be much lower.

financial costs involved in operating a microfinance institution and quantifying its subsidy dependence. The SDI is a ratio that measures the percentage increase in the average on-lending interest rate required to compensate a microfinance institution for the elimination of subsidies in a given year while keeping its return on equity equal to the approximate nonconcessional borrowing cost. The index assumes, for simplicity, that an increase in the on-lending interest rate is the only change made to compensate for loss of subsidy. An SDI of zero or lower means that a microfinance institution has achieved full self-sustainability.

For the CPEC movement, the SDI (which was over 1,000% during the first couple of years) declined from 146 percent in 1994 to 12 percent in 1996 (table 4). Thus, in 1996, interest rates would have had to be raised by 12 percent to eliminate the effects of subsidies to the CPECs. The dramatic decline in the SDI is very impressive and to a large extent a function of the CPECs lessened reliance on external funding.

PEARLS Analysis

One of the ways CPEC financial performance is measured is through PEARLS ratios, which is the equivalent of the CAMEL rating for banks.[6] The principal purpose of a financial ratings system is to provide information for both comparative and regulatory purposes. A rating system permits early detection of emerging problems and can therefore indicate measures that are needed to improve the safety and soundness of the institution. The CAMEL rating system does not allow evaluation of the financial structure and growth that are important indicators in evaluating a credit union. PEARLS was created for credit unions to be used as a management tool and subsequently became a supervisory tool as well. The PEARLS system uses 36 financial ratios to assess the viability of the credit union as a cooperative financial institution. Some key ratios obtained for the Niger CPEC movement are presented in Table 5.

The 1994 PEARLS ratios for CPECs showed a relatively good performance: decent net earnings (R_{10}) and growth in assets (S_1), loans (S_2), and savings (S_3) of more than 100 percent per year. The ratios also revealed excess liquidity (L_1) and absence of adequate loan-loss provision (P_2) despite a favorable repayment rate.[7]

Table 5. Average PEARLS ratios (%) obtained for Niger CPEC in 1993 and 1994.

Definition		1993[a]	1994[b]	Goal
P_2	Provision for loan losses/total delinquency	11.5	0.7	35
E_1	Loans/total assets	4.9	28.5	50 or higher
E_5	Deposits/total assets	48.8	56.7	70–80
E_8	Institutional capital/total assets	27.1	5.4	10 or higher
A_1	Total loan delinquency/total loan portfolio	11.0	10.5	less than 1
R_7	Total gross income margin/total avg assets	9.7	11.6	avg income yield
R_{10}	Net earnings/average total assets	11.4	12.6	avg income yield
L_1	(Total liquid cash investments–immediate obligations)/savings deposits	146.2	97.7	20 or higher
S_1	Growth in total assets	34.1	141.7	higher than inflation
S_2	Growth in loans	12.0	478.0	higher than inflation
S_3	Growth in deposits	57.5	182.2	higher than inflation

Source: WOCCU/Niger database.

a/ 20 CPECs.

b/ 37 CPECs.

Impact

To assess the impact of the CPECs, the financial structure of individuals was examined before and after they became CPEC members—based on a baseline survey in 1991 (before the CPECs) and a follow-up survey in 1995.The 1991 household baseline survey was conducted in 11 villages in Zinder department. Its results suggested that WOCCU should focus its efforts on five villages—Dungas, Maguirami, Kantché, Matameye, and Wacha. The 1995 survey attempted to revisit a random sub-sample of the 1991 participants in the villages of Dungas, Kantché, and Matameye. The 1995 survey thus included 241 individuals in the three villages of whom 116 were part of the 1991 sample.

The 1995 survey found that in Zinder individuals draw upon numerous sources of funding, both informal and formal. The informal channels that prevail include family, friends, suppliers credit, customer advances, tontines, and money keepers. Although the financial market is expanding in Niger through the expansion of the CPEC movement, formal channels used in Zinder included only two commercial banks, the CPECs, and a few NGOs. The sources of funding in the Zinder region before the establishment of the CPECs were informal loans, trade loans, and informal holdings with tontines and money keepers. After the establishment of the CPECs, individuals have added CPEC loans and deposits to their principal sources of financing.

Sources of finance for individuals' activities include both informal and formal channels, although they are concentrated on informal agents. Nearly all individuals surveyed in 1995 (99%) reported that they use retained earnings to finance their current operations. Forty-seven percent of the individuals reported that they draw upon informal sources of finance from family and friends in their current operations, compared with about 33 percent of the 1991 sample. Twenty-two percent of the individuals reported using customer advances and supplier credit to finance their business operations, compared with 52 percent in 1991. Finally, 23 percent of the interviewed individuals acquired formal finance from the CPEC or, in a few cases, from another nonbank institution for the purpose of operating their businesses.

Formal savings channels that became a part of individuals' portfolios in the 1995 sample largely consisted of accounts held with the CPECs. The informal channels continued to be represented by tontines and money keepers. Among the most common savings channels were the CPECs and, in a few cases, commercial banks. About half the 1995 sample held at least an account with a formal financial institution in Zinder. Tontines and money keepers were the second most widely used savings channels among the individuals in the Zinder region. These informal savings channels were used by 27 percent of the 1991 sample but by only 12 percent of the 1995 sample. Tontine participation declined sharply—from 25 percent of the sample in 1991 to 7 percent in 1995.

Analysis of the 1991 and 1995 Zinder samples provides several lessons about the importance of the various financial services that individuals in Zinder drew upon before and after the CPECs were established. First, cash or retained earnings were used less by traders and by farm and nonfarm enterprises with a

[6] PEARLS—protection, effective financial structure, asset quality, rate of return and costs, liquidity, and signs of growth. CAMEL—capital adequacy, asset quality, management quality, earnings record, and liquidity position.

[7] The full PEARLS rating system is shown in Ouattara and Baydas 1998.

larger number of employees; they were used more by individuals who were interviewed in both the 1991 and 1995 surveys. Second, informal loans were larger for enterprises with a smaller number of employees, for men (compared with women), and for individuals who are not members of CPECs. Third, increases in informal holdings were associated with a decreased value in physical capital, with individuals who were interviewed in both the 1991 and 1995 surveys, with men (compared with women), and with individuals who are not members of CPECs. Fourth, increases in trade loans were associated with increases in profitability, with entrepreneurs and salaried employees more than farmers, and with older individuals. Fifth, increases in deposit holdings were associated with individuals engaged in sectors of activities other than farming, with older individuals, and with men more than women. And finally, the long-term effects of using formal debt financing indicate that formal loans increase with a decreased value of physical capital, for women more than men, and for CPEC members.

The analysis of the changing financial structure provides evidence of the success of the CPECs in providing competitive financial contracts that represent relatively important services for economic units and meet a part of their demand for both savings and loan services. Moreover, the study of the agent/household's use of alternative financial instruments available in Zinder sheds light on the existing patterns of financing, their relative significance in the overall financial structure of the firm or household, changes in the financial structure, and the determinants of the existing financial contracts. It is clear that several informal and formal financial channels exist for individuals to draw upon to finance their activities and to diversify their portfolios in Zinder in 1995. However, since the establishment of the CPECs, members have been using less informal loans and savings from friends and family, participating less in tontines, and using more formal loans and savings from the CPECs.

Lessons from Overcoming Obstacles

Without doubt, the CPEC movement in Niger has attempted a difficult task: building a healthy network of credit unions from scratch in one of the most challenging environments in the world. Despite the many obstacles confronting the network, its considerable success offers invaluable insights for other institution-building efforts around the world. Although some of the obstacles were known from the outset (such as poverty, illiteracy, the regulatory and macroeconomic environment), many of the CPEC challenges have occurred unexpectedly (such as the political instability, uncertain funding, and rapid growth). The following discusses these obstacles and sheds light on the lessons learned by the CPECs in their first decade of operation.[8]

Underdeveloped Regulatory Environment

One of the biggest contributions made by the CPEC movement in Niger has been the promotion of a more favorable legal and regulatory environment for credit unions. In the 1980s the regulatory environment lacked precise legislation for credit unions. Under old laws, credit unions would be regulated under the laws that pertain to banks and agricultural cooperatives. WOCCU has been one of the active participants in the Central Bank's efforts to promote a uniform credit union law (PARMEC law[9]) for the seven francophone countries of the Union economique et monétaire ouest-africaine (UEMOA). Rather than being guided by a regulatory commission, the CPECs have been in the position of teaching the Central Bank what types of regulation are appropriate for this methodology. As a result, the CPECs have used voluntary independent audits, encouraged financial transparency, and worked with the government to enact appropriate regulation. The PARMEC law was enacted in Niger in 1996. It ensures a smooth transition of the CPECs from a provisional to a permanent legal status. Meetings with credit union managers and government officials from other UEMOA countries have been essential to promote a lasting legislative effort that will be useful to the various West African countries.

Inadequate Education and Training Levels

Another valuable contribution of the CPECs has been in the area of education and training. Although the literacy level of CPEC members greatly exceeds the extraordinarily low national average, the educational level of members remains a large obstacle to the self-management of CPECs. In response, the CPECs have provided a variety of educational and training programs for CPEC leaders including basic training on credit union operations, accounting, finance, and business management, as well as literacy training in both Hausa and Zarma, the two national languages. It has been found that one-time training is not sufficient. More than half the credit union leaders have required retraining and updating.

As the CPECs become more sophisticated by offering a variety of financial products and managing an increasing volume of assets, the level of needed education and training increases proportionately. Consequently, the network has sent staff abroad to participate in various training exercises in the United States, Canada, Benin, Togo, Senegal, and Burkina Faso. Also, regional meetings have been organized for sharing information and lessons from around the area. While necessary and useful, the cost of this intensive and recurring training is high. As external funding dries up, the extent to which on-going training is possible remains undetermined.

Instability in the Political and Economic Arena

In January 1996, a coup d'état, overthrew the democratically elected, yet controversial civilian government. For the past few years, the political system has been in disarray, creating a notable distrust of government by the public. The coup d'etat had a serious negative effect on the CPEC movement. First since the U.S. government was opposed to the coup, it precipitated the departure of USAID. This dried up donor support for WOCCU representatives in Niger and funds for training and program development. Second, the coup led to increased skepticism among CPEC members about the potential role that the government could play in the CPEC movement. Concern over government embezzlement, weak regulations, a termination of external support, and unstable government banks led to a contraction of savings mobilization and increased arrears.

In addition to political unrest, Niger has been plagued by economic uncertainty. One of the shocks to the

[8] This analysis benefited from conversations with the Roland Thurlow, WOCCU advisor to the CPECs (April 1998).

[9] The PARMEC law was developed by the Banque Centrale des États de l'Afrique de l'Ouest in 1994 with assistance from Développement International Desjardins, the Canadian credit union organization.

economy was the 100 percent devaluation of the CFA franc in 1994. Interestingly, this large monetary change did not have a negative effect on the CPECs. In fact, savings increased in the years following the devaluation as many in Niger profited from the more favorable terms of trade with neighboring countries.

Uncertain Funding

As a result of the withdrawal of USAID, the CPECs have had to confront the fear of all fledgling microfinance operations: that external funding will be withdrawn before sustained financial viability is achieved. Although much progress had been made in attaining sustainability, program managers believe that the cessation of external funds has been premature and may endanger the survival of the network. According to the managers, another 5 to 6 years of support and training would be required to ensure program viability. WOCCU evaluators predict a 50:50 chance of survival given the sudden termination of donor support (WOCCU 1997). To strengthen the network, some weak credit unions are being liquidated, and greater attention is being given to the strongest CPECs.

Liquidity Management

With the strong demand for savings instruments, many CPECs have had problems with excess liquidity. Network management recommends that only 10 percent of funds remain as cash in the credit unions, with 70 percent allocated to loans and 20 percent placed in commercial banks, but in reality about 20 percent of savings remains unproductive in CPEC safes (WOCCU 1996). Safes have been issued to each credit union to ensure the safekeeping of funds and to generate confidence among members. Nevertheless, money held there remains idle.

Few opportunities exist in Niger for the safe placement of the excess liquidity in savings instruments that offer a positive return. The commercial banking sector is unstable and offers an average 2 percent annual interest rate on savings, resulting in a negative real return. In addition, the safety of West African commercial banks remains uncertain, especially in view of the lack of deposit insurance. In Cameroon in 1989, credit unions used commercial banks to deposit excess liquidity, and four of the five major commercial banks collapsed. Although the deposits eventually were salvaged, a fear of formal financial instability persists. In Niger, the frailty of large banks such as the Banque de Développement de la République du Niger makes savers reluctant to deposit money in them. To address this problem, the CPEC network is to set up the Central Financing Facility in which CPECs can deposit their excess savings to earn a positive rate of return. The Central Financing Facility will redistribute funds to other CPECs that have a higher demand for loans. Following the coup, the only bank considered safe enough for CPEC deposits was Banque Internationale pour l'Afrique Occidentale.

The problem of excess liquidity can be addressed through proper CPEC management. The correct pricing of financial services and management of funds is critical to the smooth operation of the credit unions so that problems of excess liquidity are resolved efficiently. To encourage responsible CPEC management, the network offers management incentives. All credit unions are monitored, evaluated, and, in some cases, rewarded for their financial viability and liquidity management through regular progress reports that are distributed to all CPECs.

Growth Management and Network Formation

As a result of the rapid growth of the credit unions, CPEC management has been confronted with network and linking issues sooner than expected. The overall CPEC board is faced with planning the future and linkage strategies among CPECs. Currently, issues relating to creating a CPEC federation remain in the forefront as the board discusses the institutional structure of the CPECs and works with authorities to create a safe and efficient regulatory environment. To track the progress of individual credit unions, computerization has been implemented and uniform accounting standards are in place. Annual audits are shared at the General Assembly. In 1996, a national forum was held to critically review the movement performance, encourage slower growth, and create the Niger Credit Union National Association to monitor and strengthen credit union development.

Conclusions

The CPEC movement is an interesting case study for several reasons. First, it provides an insight into the challenges of building a credit union from the ground up. In a relatively short time, the movement has achieved a degree of sustainability and outreach. In addition, the formation of this financial institution has taken place in a harsh environment characterized by extreme poverty, illiteracy, political and economic instability, and an underdeveloped regulatory environment. Finally, it underscores the issues and challenges that arise when funding sources disappear sooner than anticipated. Clearly, if the CPECs had not focused so heavily on sustainability from the outset, emphasizing financial transparency and internal mobilization of funds, it is certain that the withdrawal of USAID and WOCCU would have led to an immediate collapse of the network. Donor funds have not been used to provide basic financial services, but rather to support continued training, education, regulatory reforms, and network creation. In the absence of external funds for these services, it is unclear how the network will progress in these areas. However, given that a strong foundation has been created, hope for continued viability remains strong. More lessons will be offered in coming years as the fledgling network attempts to offer highly valued financial services to some of Niger's low-income citizens.

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SOUTH AFRICA

Get Ahead Foundation

Craig Churchill

Get Ahead Foundation, founded in 1984 by prominent community leaders,[1] is one of South Africa's best-known NGOs. The Get Ahead Foundation of today, however, barely resembles its original incarnation. Its evolution from a broad-based, multi-faceted community development organization into a specialized microfinance institution provides important lessons for the field of microfinance. This evolution is particularly interesting because it closely parallels one of the most significant political developments of the 1990s: the democratization of South Africa.

This case study first briefly outlines some of Get Ahead Foundation's numerous activities from 1984 to 1994. These diverse projects reflect a donor-driven approach to development that was common among South African NGOs during apartheid. The end of apartheid in 1994 precipitated changes in donor priorities and indirectly caused the foundation to change its methods.

Since it began financial operations in 1988, Get Ahead Foundation's Stokvel Lending Program, a group lending scheme, has been the core of its efforts to promote black economic empowerment. The second part of the case study describes the transition of the stokvel program from a heavily subsidized loan program with poor portfolio quality toward a sustainable financial institution—a process still far from complete. The reforms of the stokvel program reflect broader changes at the foundation as it has gradually shed most of its nonfinancial activities to focus on its comparative advantage—micro-lending.

Country Context

The South African environment is politically, socially, and economically unique. South Africa experienced 50 years of apartheid that disfranchised the majority of the country's population. The economic inequalities are startling: the poorest 40 percent of households in South Africa earn less than 6 percent of the country's total income, while the richest 10 percent earn more than half total income. Africans comprise three-quarters of the population, but their earnings amount to only 29 percent of total income. Whites, who comprise less than 13 percent of the population, earn 58 percent of total income. On average, white South Africans are nine times richer than black South Africans (*Economist*, March 20, 1995). The GNP per capita, US$3,010 in 1994, is very high compared with other sub-Saharan African countries because of the wealth of the white population. However this figure is misleading in that it does not

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demonstrate the poverty level of a large part of the South African population.

The election brought great political optimism to a country that had recently been on the brink of civil war. The economy has improved since the election, although not keeping pace with political progress. Economic growth in 1995 was approximately 3.5 percent, but it was not nearly enough to reduce black unemployment.

South Africa's unemployment problem is acute. In the early 1960s, over 80 percent of new entrants to the labor force were able to find formal-sector employment, but by the late 1980s only 8.4 percent found formal-sector work (Jenkins 1992). With approximately 400,000 new entrants to South Africa's labor market each year, the formal sector can only absorb 150,000 at the economy's current growth rate or 200,000 if growth reaches 4 percent (Pollack 1993), which would be optimistic because on average from 1975 to 1991 South Africa's GDP grew 1.4 percent a year (Patel 1993). Much of South Africa's violence is related to unemploy-ment. For democracy to have a chance, the new government must create the conditions for the growth of employment. Investments in the informal sector present one opportunity to do so.

Multiple Facets of the Get Ahead Foundation 1984–94

From 1984 until South Africa's first all-race election in April 1994, Get Ahead Foundation fought the effects of apartheid through a vast array of economic and social interventions. In addition to the Stokvel Lending Program, the foundation's multifaceted approach included:

- social programs such as education and primary health-care projects
- financial services such as a business loans program for individual entrepreneurs, a commercial partnership lending program to link formal and informal businesses, and programs to promote housing loans and village banking
- nonfinancial services such as technical and business skills training, formation of trade associations, marketing services for small-scale industry products, and a job creation project

All these projects contributed loosely to the foundation's mission to promote black economic empowerment. This diffusion of efforts reflected the diversity of needs of the African population under apartheid, and the interests of international donors seeking to meet those needs. Since donors did not channel resources through the apartheid government, they helped NGOs to provide critical services to African communities. Get Ahead Foundation attracted significant contributions from international and local donors through a well-developed public-relations campaign and a prominent board of directors However, each donor had a separate agenda, and the foundation became the vehicle for their purposes. An evaluation by the German donor, GTZ, in 1994 aptly described Get Ahead Foundation as "a jack of all trades, master of none." The evaluation should have induced the donor community to accept some responsibility for this condition.

Although the Stokvel Lending Program was the organization's most significant activity, directly employing more than half the foundation's staff, the program had to compete with the full array of other development initiatives for the attention of senior management. Since each

[1] Including Archbishop Desmond Tutu and Dr. Nthato Motlana, who was Nelson Mandela's personal physician, the Chairman of Get Ahead Foundation, and the Chairman of Metropolitan Life, the largest black-owned company in South Africa.

program required a program manager, the foundation's organizational structure became top-heavy and lacked clear lines of command. In addition, the diversity of its activities produced a record-keeping morass. The finance department did not effectively segregate income and expenses by program, which prompted donor suspicions of com-mingled funds and made it impossible to produce a balance sheet or an income statement just for the stokvel program.

In the original design of the group and individual lending programs, financial services were supposed to be delivered separately from nonfinancial services such as marketing and training. In the 1992 USAID evaluation, Get Ahead Foundation was commended for having separate divisions for financial and nonfinancial services. However, from the perspective of the foundation staff, and especially the administrative systems, no such separation existed.

April 1994 was the turning point for Get Ahead Foundation. That month marked South Africa's political transition to a multiracial democracy. The election caused a change in donors' priorities. They now wanted to assist the new government and began redirecting their resources away from NGOs. The possibility that donors might discontinue funding caused the foundation's management to change their perspective. Previously, they had paid lip service to financial sustainability for their lending activities, but after April 1994 they began to take it seriously. This accelerated the process of reform within the Stokvel Lending Program, described below, and finally caused the foundation to separate its lending operations from its development activities. This led to the creation of Get Ahead Financial Services (GAFS) to manage the stokvel program, as well as a graduate loan pilot project, and Get Ahead Development to lead the remaining development activities: primary health-care, business and technical training, and support for business associations.

During the first decade of its existence, Get Ahead Foundation was indeed a jack of all trades, participating in a host of development activities to promote black economic empowerment. Consequently, the foundation did not excel at anything and its impact was limited. Changes in donor priorities forced it to reconsider its mission and to focus on improving its comparative advantage: the Stokvel Lending Program.

Redefining the Stokvel Lending Program

Most micro-lending programs that started in the mid-1980s were primarily concerned with the number of beneficiaries rather than with the viability of the institutions they were helping. This perspective implicitly assumed that donor support was limitless. That attitude could not last. The realities of finite donor support and escalating global poverty have now forced the microfinance field to undergo a shift toward the financial systems approach to microenterprise development.[2] The basic characteristics of this approach are charging interest rates sufficient to cover operating and financial costs, utilizing sound management systems and business planning, and raising lending capital from the financial markets at nonsubsidized rates by mobilizing public savings, borrowing from commercial banks, or floating paper and issuing equity shares. The object is to create sustainable institutions that provide financial services to disadvantaged communities over the long term. This section[3] recounts the experience of Get Ahead

Foundation's Stokvel Lending Program as it struggled to adopt the new approach.

When the Get Ahead Foundation began issuing micro-loans to black-owned businesses in 1988, the organization was praised for its efforts to combat the effects of apartheid. With financial and technical assistance from USAID, the foundation adapted a Grameen Bank-type group-lending approach to South African conditions. It called its groups *stokvels*, the name used by traditional savings clubs in the black community. There are a great variety of stokvels in South Africa and their origins can be traced back to the latter part of the nineteenth century. Among the most important stokvels are "burial societies, established to help blacks face high costs of funerals that play an important role in black culture" (Lukhele 1990).

Get Ahead Foundation's Stokvel Lending Program faced great difficulties. The situation in South Africa created a challenging environment for micro-lending. International sanctions had isolated South Africa from the rapidly advancing field of microenterprise finance. While the rest of the world was adopting methods for the provision of sustainable financial services to the poor, South African programs were mired in the donor-dependent approach to micro-lending that dominated microenterprise development in the mid-1980s.

This isolation was compounded by hostile political conditions and a culture of nonpayment. Apartheid policies stifled the informal economy. Black entrepreneurs could not operate in certain business sectors or in lucrative geographic areas. Businesses that ignored government guidelines were forcibly removed and their stock confiscated. To protest against the severe conditions, many urban communities boycotted rent and other payments that were due to local governments. This produced a culture of nonpayment that adversely affected repayments of all kinds, including loan repayments to the Get Ahead Foundation. These conditions made it difficult for the Get Ahead Foundation —or any South African micro-lending program, for that matter—to grow while maintaining any degree of quality. The foundation's difficulties were compounded by frequent management turnover and the lack of institutional focus, which was demonstrated by the diversity of projects in which it was involved.

Portfolio Decline

Get Ahead Foundation's initial agreement with USAID established quality and quantity targets for continued support. From 1988 to 1990, the Stokvel Lending Program grew slowly and steadily, and maintained a healthy portfolio. But in its fourth year, soon after senior management changes, the foundation expanded beyond its institutional capacity in order to reach the volumes stipulated in the USAID contract. In 1991, the program exploded from 2,400 borrowers in January to nearly 8,000 by the end of the year.

While management wanted to grow to impress USAID and other donors, field staff were determined to help the disadvantaged population by getting as much money into as many hands as possible. Branches in politically sensitive townships, including Soweto and the East Rand, made only minimal efforts to collect repayments. If clients repaid their loans, that was a benefit, but from the staff's perspective, the primary objective was economic redistribution. Furthermore, it was dangerous for loan officers in certain

[2] The principles of the financial systems approach are outlined in Otero and Rhyne 1994.

[3] Adapted from Churchill 1997.

townships to attempt to recover their loans.

With branches in more than 20 townships around the country, the foundation had spread itself too thin. It was not able to manage such broad geographic coverage effectively. In discussing repayment problems, staff and management often referred to the "culture of nonpayment" that existed in townships as a form of political protest. This characterization of delinquency somehow made it more palatable to them. Some branches mistakenly believed that their loan quality was acceptable. USAID required the foundation to maintain a repayment rate of 85 percent, but did not realize that the foundation measured repayments incorrectly.[4] In addition, the turnover of senior management resulted in a serious loss of expertise. New managers were not familiar with group lending, and the foundation's cohesion was weakened.

USAID's 1992 program evaluation discovered severe problems including a portfolio at risk of 60 percent (Christen et. al 1994).[5] Eventually, the program would write off more than R1 million.[6] Fortunately for the foundation, USAID assumed partial responsibility for the predicament and remained committed to a continued relationship despite the poor track record. With a 3-year agreement in hand, Get Ahead Foundation began the process of correcting its mistakes. However, it was not until early 1994, when USAID actually threatened to terminate its relationship with the foundation, that the reforms began in earnest.

Problem Identification

To turn the program around, the foundation sought assistance from Calmeadow, a Canadian nonprofit organization that provides technical assistance to microfinance institutions that are committed to self-sufficiency and outreach. With Calmeadow's support and a new management team, Get Ahead Foundation conducted a critical review of its situation and identified four categories of problem: a loose lending methodology, poorly trained and demoralized staff, poor management information, and poor customer service.

Loose Lending Methodology

The group methodology was not strictly applied, especially after 1991. Borrowers often repaid as individuals, and field workers did not require groups to pay for members who defaulted. Field workers commonly formed groups by putting people together who did not know each other, because they wanted to increase their volumes, or to assist poor people, or because they did not know any better.

Get Ahead Foundation did not have a delinquency management policy. Borrowers' repayment dates varied throughout the month, which created inefficient branch procedures. Most loan officers did not know when their groups were supposed to pay, and therefore contact with nonpaying groups occurred only after month-end, if then. Most staff assumed a charitable approach to lending, which made them sympathetic to borrowers' excuses. Finally, there were no consequences for late payment or default. Frequently, individuals who had repaid their portion of the group loan were allowed to join new groups to receive repeat loans.

Poorly Trained and Demoralized Staff

The apartheid educational system left South Africa with an unskilled African labor force. Some of the foundation's field staff lacked the academic skills to do their jobs adequately. A well-intentioned company policy to train staff did not always meet organizational or individual needs. Most staff did not have a thorough understanding of what they were doing or why. Others were hired for their political contribution to the struggle against apartheid rather than for their skills or experience.

Mixed messages from the head office in Pretoria undermined field staff morale. In early 1991, the message was "disburse, disburse, disburse," but by the end of the year, disbursements were suspended and staff were expected to "collect, collect, collect." At the branch level, gender tensions complicated working conditions—at the end of 1993, all branch supervisors were male and 95 percent of field workers were female.

In the 1980s, South African labor unions provided one of the few legal means of challenging the establishment. The strength of the labor movement reached the NGO community, and Get Ahead Foundation's staff felt compelled to unionize. The formation of a union further hurt a shaky relationship between staff and management and significantly increased salary costs.

Poor Management Information

Get Ahead Foundation's isolation from the rapidly advancing field of micro-enterprise finance had major implications for its management information. The program incorrectly calculated some key performance indicators, and others were not measured at all. As a result, management did not realize the severity of the problem. The foundation received unreliable computer advice from several consultants, which delayed the improvement of its reporting systems. When management information was available, it was often several months late and of questionable accuracy. The lack of timely and accurate information made the program vulnerable; staff fraud was prevalent.

This was compounded by the geographic diffusion of the foundation's offices. Instead of expanding organically by opening new offices when existing offices reached capacity and were sustainable, the foundation opened offices across the country in response to donor requests or political pressure. This resulted in an excellent national network, but significantly increased the organization's overhead costs. Get Ahead Foundation did not have the institutional capacity to manage so many offices, and information did not flow systematically between the branches and the head office.

Poor Customer Service

Based on USAID's original program design, the foundation only issued loans for 12-month terms. After conducting market research in 1993–94, the foundation realized that its product was inappropriate for the needs of its clients. Borrowers complained that loans were too small and the loan term was too long.

There was also a problem with product delivery. Administrative systems at the head office were not prepared to serve large volumes of borrowers. As a result, the Stokvel Lending Program issued loans irregularly and field staff did not know

[4] When calculating the repayment rate, Get Ahead Foundation did not include the arrears portion of the portfolio in the amount due. The foundation also included prepayments in the amount received, so if some groups paid in advance it masked the fact that other groups had not paid. Get Ahead Foundation regularly reported that several branches had repayment rates well in excess of 100%, when in fact they had severe delinquency problems.

[5] Portfolio at risk is calculated as the entire balance of loans in arrears divided by the outstanding balance of the portfolio. Get Ahead Foundation capitalizes its loans on disbursement, and therefore both the numerator and denominator include principal and interest due.

[6] The value of US$1.00 was R2.9 in 1993, R3.3 in 1994, and R3.6 in 1995, and R4.3 in 1996.

when the next disbursement checks would be available. With inefficient application processing and occasional cash-flow problems, 2 or 3 months might pass between application and disbursement. This was inconvenient for borrowers and made it difficult for them to plan cash flows. Disbursement delays also contributed to the demoralization of field staff, since they were faced with irate borrowers who had already paid a group guarantee of 10 percent of the loan to serve as cash collateral and wanted to know when they would receive their loans.

Staff attitudes toward Get Ahead Foundation and their clients were another cause for concern. Because USAID covered operational costs, field staff did not appreciate the importance of interest income generated by their loan portfolios. Without a link between salaries and performance, the only incentive for staff to achieve high performance standards was to help their community. That motivation assumed a variety of manifestations depending on the branch. In some offices, field workers enjoyed the power of issuing loans and assumed a superior attitude toward their clients. Consequently, the delivery of quality customer service at the branch level was often lacking.

Interventions

To address these problems, Get Ahead Foundation established a task team to design and implement a series of reforms. The task team consisted of a new deputy managing director with commercial banking experience, an operations manager, a director of training who was responsible for both staff and client training, a consultant from Calmeadow who visited South Africa on a quarterly basis, and a consultant who was hired for 12 months to facilitate and implement modifications in the Stokvel Lending Program. Most of the changes described below were introduced between April and July 1994.

Lending Methodology

Previously, Get Ahead Foundation's clients applied for loans as a group, but the stokvels would often disintegrate once the money was in their hands. To reinforce the group approach, the foundation began to issue one check per group, rather than one for each borrower. This also reduced the program's bank fees. The foundation began to require a group savings account, called a club account, which clients could use to pay for a member who was having difficulties in a particular month. The club account promotes stokvel cohesion by giving members further reason to function as a group.

Get Ahead Foundation introduced several other refinements to utilize the group methodology effectively. Before disbursement, loan officers now ensure that group members know each other well by asking a series of questions designed to test familiarity and trust. Prospective clients are required to assess the businesses of the other group members. If one business is not strong, the members should remove that person because they do not want to guarantee a loan for a weak business. To supplement the group members' assessment, the foundation requires loan officers to visit each applicant's business and complete a rudimentary evaluation before approving the loan.

A key aspect for achieving sustainability is to promote timely payments. All borrowers are scheduled to pay on one of four repayment days each month. Loan officers know which stokvels pay on which days, and any group that misses its repayment day receives a visit from the loan officer the next day, if possible. Loan officers have adopted a strict policy not to accept partial payments. Groups that want to pay a portion of the amount due are turned away until they are prepared to pay the entire installment. To penalize late-payers, Get Ahead Foundation introduced a delinquency fee of R1 per member per day for stokvels that miss their repayment day. If a member is unable to pay in a particular month, the group is expected to withdraw money from its Club Account to avoid delinquency. The foundation reinforces the importance of the group by applying the consequences of delinquency and default to all members equally, i.e., no further loans are available to any member of the group until all members are current.

Staff Training and Motivation

In early 1994, Get Ahead Foundation moved to create an efficient branch structure by closing several nonperforming offices. This sent shock waves through the remaining branches because Get Ahead, for the first time, was aggressively responding to poor performance. The union intervened in an attempt to stave off retrenchment, but management clearly demonstrated that the long-term viability of the foundation required drastic improvements. If the foundation maintained the weak branches, the entire organization would go under. At the same time, management and methodological changes strengthened field staff.

The remaining offices were reorganized into 10 centers, each supervised by a center manager. Previously, they were known as supervisors, but the change to "managers," and a corresponding increase in responsibility, created accountability. Field workers were also given new titles and job descriptions to focus their attention on lending activities. Now called loan officers, they have complete responsibility for the client relationship from promotion to disbursement to collection. Before, branch supervisors shared responsibility for the application process, and final loan decisions were made at the head office.

To ensure a well-trained workforce, the task team developed a comprehensive training curriculum that provided loan officers with background information on microenterprise development and group lending. All loan officers participated in 2-week training courses in April and June, 1994. Through this course, management ensured that loan officers understood the reasons why the changes in method were necessary. The course also created a forum for field staff to define the details of the reforms. The task team established the broad principles behind the new policies, but actively involved staff in determining the specifics.

To motivate staff and reduce resist-ance to change, Get Ahead Foundation created a monthly incentive pay scheme that rewarded portfolio quality and quantity. Results of the incentive scheme are publicized in a quarterly news bulletin developed by the Stokvel Lending Program to increase staff awareness of activities in other offices. The news bulletin identifies the "loan officer of the quarter," and this creates a healthy rivalry among staff members. This competition culminates in an annual awards ceremony where the loan officer of the year and center of the year receive trophies, and other awards are also given.

Center managers now maintain a small portfolio of approximately 10 to 15 stokvels. This policy was designed to help middle managers understand the challenges faced by loan officers, thus creating empathy between managers and staff. It also forms the foundation of Get

Ahead Foundation's growth strategy. Center managers draw their portfolios from the geographic area with the most potential so the next loan officer hired can inherit existing groups and be productive immediately.

Reliable Management Information

As we have seen, loan officers scheduled their stokvels to pay on one of four repayment days each month. These standardized dates improved staff efficiency and allowed management to monitor the repayment performance closely. After each repayment day, loan officers fax reports to the head office to relay immediate repayment information. A new computer system now produces timely and reliable reports to monitor loan officers' performance, to compare their achievements with their targets, and to measure incentive scheme indicators. With this information, management can prevent loan officers with poor repayments from disbursing to new stokvels. If a loan officer's repayment rate[7] drops below 85 percent, he is not allowed to issue loans to new groups until his recoveries surpass that threshold.[8] This new policy should ensure that the stokvel program only experiences quality growth.

At the end of the month, the head office prepares a battery of reports for senior management and for each center. Get Ahead Foundation's main performance indicator report includes disbursement, repayment, delinquency, and portfolio-at-risk statistics for loan officers and centers, and a consolidated report for all areas. In addition, the Stokvel Program prepares the following monthly reports: bad debts, aging of arrears, and aging of portfolios at risk.

Improved Customer Service

The Stokvel Lending Program piloted short-term (4- to 6- month) loans in mid-1994, and introduced them in all offices by the end of the year. With the previous 12-month terms, loan officers had maintained weak groups in their portfolio for months. Now staff identify poor-paying stokvels quickly and do not issue a repeat loan to them. The group also benefits because it can remove a difficult member when the stokvel applies for its next loan. Since most clients borrow money for working capital, it is easier for them to repay short-term loans, despite the larger installments, because they achieve an immediate return on their investment. Experience has shown that microentrepreneurs repay their loans primarily because they want to receive another loan, but they lose that motivation if the next loan is still 8 or 9 months away. Short-term loans also address borrowers' concerns about small loan sizes, since good-paying groups can quickly increase their loan amounts.

A systematic disbursement system has significantly improved customer service. Get Ahead Foundation disburses once a week to correspond with the four repayment days. To offer a reward to groups that pay on time, the stokvel program developed fast loan renewal. Stokvels that repay on time every month can apply for a repeat loan with one installment remaining. When the stokvel pays its final installment, it receives its next loan on the same day.

Besides short-term loans and a reliable disbursement system, the most significant improvement in the provision of customer service was accomplished when Get Ahead Foundation convinced staff that their salaries are paid from the interest generated by their loan portfolio. This insight, achieved through training sessions and repeated messages from management, changed the staff's attitude toward their clients. This was particularly successful because the deputy managing director assumed primary responsibility for customer service training. Whenever there was a gathering of field staff, he always delivered a motivating presentation about the critical importance of customer service.

Institutional Structure and Financial Products of GAFS

As a result of the many changes in the Stokvel Lending Program, the institutional structure and financial products of Get Ahead Financial Services (GAFS) have been greatly improved.

Institutional Structure

In June 1996, GAFS had 10 branches (called centers) in five provinces, and a total staff of 60 persons of whom 16 were at the head office. Branches consist of a center manager and 2 to 10 loan officers. Centers usually include a main office in the business district and several satellite offices in the townships. Although it varies from center to center, disbursements and repayments usually occur at the main office, and other client meetings take place at the satellite or main office closest to the clients.

The lack of geographical concentration may be useful in the future as Get Ahead Foundation prepares to increase its impact throughout the country, but currently it provides a challenge for management. Incentives for staffs that perform well and management information systems are all the more critical in this situation.

Human Resource Development

Get Ahead Foundation has made significant changes to its staff development. Through training sessions, performance incentives, and a more open approach, senior management has improved relations with field staff. The new management of the Stokvel Lending Program has invited participation from every layer of the organization. As a result, the union has lost support from staff and is no longer recognized.

Hiring Policies. Get Ahead Foundation has learned a great deal through many years of errors about hiring the right people for its field staff positions. In the past, Get Ahead Foundation primarily hired middle-aged women for the position of loan officer because it was believed that they would command respect from their clients. Many of the center manager positions were filled by former political prisoners who had strong connections in the community and a commitment to community development, but usually no finance or credit background. More often than not, these hiring decisions resulted in loan officers who spent most of their time sitting in the office waiting for clients to come to them and managers who spent a lot of time attending community meetings and promoting their political agenda.

New loan officers are now usually younger (in their twenties), better educated, and more committed to the foundation's mission than the more experienced staff members. Center manager qualifications include a finance diploma and relevant work experience. Thirty percent of the center managers are now female and Get Ahead Foundation is hiring an increasing number of male loan officers.

Compensation and Incentive Scheme. The monthly base salary for loan officers ranges from R1,400 to R2,300 (US$325 to $535) depending on their experience and

[7] The repayment rate is now calculated by dividing all repayments received in a month, less prepayments, by the total amount due, which includes current installments and arrears.

[8] Some center managers have independently adopted a more stringent threshold of 90%. As the program's repayments improve, the higher criterion will probably become universal.

Table 1. Incentive payments (in rands) under Get Ahead Foundation's loan officer incentive scheme.

Repayment rate (%)	Number of groups 40–49	50–59	60–69	70–79	80–89	90+
90–93	100	250	400	550	700	800
94–97	150	300	450	650	800	900
98–99	200	350	500	750	900	1,000
100	250	400	550	850	1,000	1,100

seniority. This salary is supplemented by a monthly incentive. Get Ahead Foundation has tried several forms of performance incentive. Incentives offered in the early days of the Stokvel Lending Program rewarded growth at the expense of quality, only to be discontinued after the expansion of 1991. In 1994, staff incentives were reintroduced with a heavier emphasis on quality indicators. This scheme has been revised, and simplified since then; its current form is outlined in table 1.

To qualify for incentives, loan officers must have a minimum of 90 percent repayments and 40 stokvels. Center managers receive 25 percent of the incentives earned by loan officers who report directly to them and 5 percent of the incentives of staff who report indirectly to them through senior loan officers. Senior loan officers earn their own incentives and 20 percent of the incentives earned by loan officers who report to them. If the center's repayment rate drops below 90 percent, center managers are not eligible for incentives. On average, incentives account for 30 percent of the total salary of the field staff. This incentive scheme has helped to boost staff morale. For the quarter ending in December 1995, nearly three-quarters of the experienced loan officers qualified for incentives, and the top performer increased her monthly salary by two-thirds.

Get Ahead Foundation also provides its head-office administrative staff with a share of the incentives. Five percent of all the incentives earned by field staff in a particular month are shared between the four clerks at the head office. Currently, there are no incentives or bonus arrangements for senior management.

Performance Expectations. Get Ahead Foundation expects new loan officers to manage loans of 40 stokvels after 12 months. Get Ahead Foundation has learned that loan officers whose portfolios grow too quickly probably do not spend enough time with the social intermediation aspects of the methodology, and they will inevitably experience deterioration in quality. Therefore, new loan officers are not permitted to add more than six new groups per month. During their second year, loan officers are expected to expand from 40 to 70 groups, while maintaining a minimum repayment rate of 90 percent.

Management Information Systems

To manage growth and performance, GAFS has been improving its management information system over the years. In 1996, the system was being redesigned to accommodate a more decentralized structure that allows applications and receipts to be entered at the branches—although none of the branches currently has computers. Theoretically, this would improve customer service by shortening the period between application and disbursement. Another improvement would be to link clients' data and the institution's financial information. Other considerations for this new system included government regulations for banking systems if GAFS becomes a regulated financial institution and the possibility of adding a savings component at some point in the future.

Get Ahead Foundation also established systems to improve the flow of information between the branches and the head office. Stokvel management knows immediately which groups miss their repayment dates because loan officers fax their monthly repayment schedule to the head office, detailing who was expected to pay and who paid. As a part of the stokvel program's hands-on management approach, the operations manager and the stokvel administrator are in constant communication with field staff about their performance during the course of the month. This immediate follow-up by management is the same approach that GAFS expects from its field staff.

Loan Products

GAFS does not offer savings products. It mainly offers group loans and has started testing individual lending.

Loan Characteristics

Group loans are available for four different loan terms: 4, 6, 9, and 12 months. First-time borrowers only have the option of a 4-month loan, but as groups return for repeat loans, their term options increase. Get Ahead Foundation's experience with short-term loans (4 and 6 months) suggests that they have significantly improved the quality of the portfolio. Consequently, loan officers are encouraged to steer stokvels to the shortest term possible.

The loan sizes are strictly regulated for a stokvel's first four loans. After a group has successfully repaid four loans, loan officers have more flexibility with loan sizes and terms. Loan requests above the

Table 2. GAF interest rates, 1995.

Loan term (months)	Flat interest per loan term (%)	Effective interest (%)	Installment per hundred rands (R)
4	12	66.4	28.00
6	17	66.7	19.50
9	21.5	58.4	13.50
12	26	63.6	10.50

maximum amounts for each loan number may be granted under special circumstances. The maximum amount available from the Stokvel Program is R5,000 (US$1,160).

In response to the demand for larger loans, Get Ahead Foundation has begun a pilot project for individual, graduate loans. GAFS provides individual loans to clients who have received at least three group loans, the last of which was at least R2,500 (US$580) and have a perfect repayment record. So far, this pilot project has disbursed only a few loans, and therefore it is too early to judge its merits.

Get Ahead Foundation charges a flat interest rate at the beginning of the loan term, and therefore all information regarding outstanding balances includes both principal and interest. The interest rates are summarized in table 2. The effective interest rates are calculated to include the cost of the up-front guarantee of 10 percent. With inflation in South Africa at approximately 8 to 9 percent per year, the real effective interest rates run from 41.5 to 53.5 percent.[9] In October 1996, Get Ahead Foundation decided to increase its effective interest rates to an average of 70 percent (not including the cost of the up-front guarantee).

For several years, GAFS has no longer been relying on donor grants to fund its loan portfolio. It now borrows from private commercial banks, primarily

[9] Annual inflation was 9.7% in 1993, 9.0% in 1994, and 8.6% in 1995, and 7.4% in 1996.

Standard Bank, which offer overdraft accounts. The cost of borrowing from these banks is 18 to 19 percent (effective rate). Increasing the interest rate to 70 percent has left the institution with a comfortable spread of 50 points.

Borrower Criteria and Group Formation

To receive a loan, prospective borrowers form themselves into self-selected groups of five to eight business persons. Loan officers do not assist in the selection of members. Members cannot be from the same family or living at the same address. They must know and trust each other. It is also preferable, though not required, that clients live near each other and work in similar types of business.

Get Ahead Foundation has learned through market research that the primary reason why stokvels stop borrowing is because there are problems with one or two group members, and the group has difficulty replacing them. For repeat loans, Get Ahead Foundation has reduced the minimum number of clients per group to four for the second loan and three after the third loan.

Loan officers have an important role in shaping the attitudes of the groups and ensuring that they fully appreciate their responsibilities toward each other. This pre-loan phase, which represents the social intermediation aspect of GAFS' methodology, includes three or four meetings with the group to examine important issues such as terms and conditions, and group cohesiveness.

Overall, it takes about 4 to 6 weeks from the time the stokvel is formed until disbursement. Get Ahead Foundation feels that this long application period is necessary for first-time borrowers to build solid borrower groups in a township environment characterized by a lack of trust, a transient population, high crime, and less community involvement than in rural areas.

Disbursement and Contract

At the disbursement meeting, the loan officer reviews the repayment procedures and the penalties for late payment with the group. Group members sign the loan agreement in which they agree to be jointly and severally liable for the loan. The check is then handed to the group leader with a reminder that she or he is responsible for ensuring that the group repays the loan amount plus interest. The group goes to the bank, cashes the check, and divides it among themselves.

Groups with perfect repayment records are eligible for fast loan renewals, which means that they will receive their next loan when they repay the last installment of their previous loan. Stokvels with less-than-perfect repayment records may still be eligible for repeat loans as determined by the delinquency management policy described below.

Repayments

Repayments of stokvel loans occur monthly because many microentrepreneurs sell on credit to salaried individuals who get paid once a month. For this reason, it is difficult to increase the frequency of repayments. Monthly repayments also reduce the transaction costs for Get Ahead Foundation and the borrower.

The repayment procedures vary depending on the branch's proximity to a bank. If a bank is near, the client first comes to the office with the installment and the loan officer completes the deposit slip. The client deposits the payment at the bank and then returns to the office with the deposit slip carbons. The loan officer issues an official Get Ahead Foundation receipt that is attached to the stokvel's repayment form. If the Get

Ahead office is not located near a bank branch, loan officers usually wait at the bank on repayment day to assist their clients with deposits. This repayment process was designed so that loan officers do not handle money and to increase office security. Previously, loan officers collected repayments at the office and then deposited a day's worth of receipts at the bank, exposing both Get Ahead Foundation and the loan officer to unnecessary risks.

After each repayment date, loan officers fax their repayment schedule to the head office. The repayment schedule shows which groups were expected to pay, the amount expected including arrears, and the amount paid. This procedure allows the head office to know immediately if a loan officer is experiencing delinquency problems.

Delinquency Management

Any stokvel that misses its repayment is supposed to receive a visit from the loan officer the next day. Loan officers with large geographic areas and a high number of delinquencies, however, may not reach everyone immediately.

To manage delinquency, Get Ahead Foundation uses a carrot and stick approach with both clients and staff. With the borrowers, the primary carrot offered for timely repayments is access to a fast loan renewal and a loan of greater value. The stick is fairly painful. Delinquent groups are charged R1 (US$0.23) per day per group member for every day that they are late up to a maximum of 10 percent of the loan amount. This is actually a higher penalty than if the interest were capitalized on the due date. It is more easily understood by both staff and borrower, and Get Ahead Foundation believes that it more effectively encourages timely repayments.

Get Ahead Foundation uses two additional sticks to promote on-time repayment. First, stokvels that are delinquent twice during the loan term are not eligible for fast loan renewal. If they apply for a repeat loan, they must wait until the following month for disbursement. Second, stokvels that are delinquent three times during the course of one loan term are not eligible for larger loans and are suspended from access to repeat loans for 2 months.

Loan officers are also subject to the carrot and stick approach. For its loan officer incentive scheme (the carrot), Get Ahead Foundation measures the repayment rate as the indicator of portfolio quality at the end of each month. The stick establishes minimum repayment rates for the loan officer to be eligible for incentives and to disburse to new stokvels. As seen previously, loan officers must have a repayment rate of at least 90 percent to earn incentives and 85 percent to disburse to new stokvels. This ensures that loan officers with quality problems do not expand their portfolios until those problems are solved.

Center managers get actively involved in delinquency management with groups that are more than 2 weeks late. They visit the group leader and may call a stokvel meeting to try to resolve group problems. In some offices, center managers have relations with influential members of the community, such as the *indunas* (head men) or civic associations, and may call upon these resources when dealing with persistent problems. Any loans that are more than 3 months in arrears are considered bad debts. When a loan becomes a bad debt, center managers may enlist debt collectors or lawyers.

Write-Off and Provision Policy

Get Ahead Foundation has adopted, but not implemented, a formal write-off and provision policy. In the past, a provision was made once a year to ensure that 100 percent of all arrears were provided for and that loans that were outstanding for more than 3 years were written off. In its revised format, provisions are made quarterly according to the following policy:

Arrears (days)	*Provision (%)*
0 to 30	0
31 to 60	25
61 to 90	50
91 to 120	75
Over 120	100

Loans more than 12 months past due are written off.

Results

The methodological and institutional changes described above have resulted in significant improvements in outreach, productivity, and portfolio quality.

Outreach

The number of clients in the Stokvel Lending Program has increased dramatically. The program grew from 1,710 clients in March 1993 to nearly 9,500 borrowers in March 1996 (table 3). Although there are parallels with the reckless growth of 1991 when the Get Ahead Foundation expanded by 230 percent in 12 months and exceeded 8,000 borrowers, the changes implemented in 1994 should ensure that the foundation now experiences quality growth.

The average monthly disbursement has increased more rapidly than the number of active clients for two reasons. First, with the introduction of 4- and 6-month loans in all branches at the end of 1994, the turnover of the portfolio increased from once a year to nearly twice a year. While short-term loans had a positive impact on repayments, the escalation of monthly loan applications and disbursements put a strain on institutional capacity, not to mention cash flow.

The second reason that disbursements have increased faster than the client volume is that the average loan has gradually increased. This does not indicate a change in institutional policy toward wealthier borrowers; rather it reflects the retention of repeat borrowers. With the shorter loan terms, clients are able to

Table 3. Number of clients and monthly disbursements, Get Ahead Foundation, 1993–96.

Date	Active clients (no.)	Avg monthly disbursement R000	Avg monthly disbursement US$000	Outstanding portfolio R000	Outstanding portfolio US$000
3/93	1,710	21	7.3	756	261
6/93	1,956	121	41.6	940	324
3/94	3,151	192	58.1	1,358	412
6/94	4,953	340	103.1	2,396	726
3/95	6,676	571	158.7	3,099	861
6/95	9,077	960	266.8	4,467	1,241
3/96	9,481	1,432	333.1	6,418	1,493

Table 4. Average loan size disbursed, GAF, 1993–96.

Year	Total amount disbursed R000	Total amount disbursed US$000	Individual disbursements (no.)	Average loan size disbursed R	Average loan size disbursed US$
1993	1,888	651	3,230	585	202
1994	4,295	1,301	6,052	710	215
1995	11,887	3,302	16,146	736	204
1996 (3 mo.)	8,574	1,994	9,708	883	205

Table 5. Number of borrowers per field staff, GAF, 1993–96.

Date	Field staff (no.)	Avg portfolio per field staff (R000)	Borrowers/ field staff No.	Borrowers/ field staff Change (%)
6/93	42	15.1	44	
12/93	43	44.3	75	42.0
6/94	42	34.7	90	16.6
12/94	38	96.0	166	45.7
6/95	43	82.1	184	10.0
12/95	42	154.6	234	21.4
6/96	44	164.9	224	-4.6

increase their loan amounts more rapidly. This is apparent in table 4. When short-term loans were introduced at the end of 1994, they were accompanied by a reduction in the maximum size of the first loan from R700 (US$212) to R500 (US$150), therefore delaying the growth in the average loan size in 1995. In the first half of 1996, over 70 percent of the disbursements were for repeat borrowers. This accounts for the 20 percent increase in average loan size during the first 3 months of 1996.

In 1994, 90 percent of the clients were women; 70 percent of these women were either heads of households or primary breadwinners. Stokvel borrowers were on average 48 years old and had attended an average of 6.3 years of school. Thirty-eight percent of borrowers were illiterate. The majority of clients were involved in trade as hawkers (46%) or retailers (14%). Thirty-three percent of clients were manufacturers, involved primarily in textiles such as dressmaking. Sixty percent of clients operated their businesses out of their homes. The typical GAFS client was a middle-aged, single mother (or primary breadwinner), responsible for five children or grandchildren, unable to find formal-sector employment.

Productivity

Get Ahead Foundation's dramatic growth during this 3-year period was coupled with significant improvements in its productivity, demonstrated by the number of clients and portfolio size per field staff[iii] (table 5). In June 1996, GAFS had only two more field staff than it had in June 1993, but it had added more than 8,000 clients!

The best performing loan officers manage 70 to 80 stokvels, which translates into 325 to 400 individuals. Since loan officers have only recently reached these levels, it is not yet clear if these volumes are sustainable. Other variables, such as the geographic diffusion of the clients and the age and quality of the portfolio, also affect the loan officer's ability to maintain this volume of clients.

Portfolio Quality

These rapid increases in outreach and productivity would be worthless if they were not accompanied by corresponding improvements in the quality of the portfolio. GAFS uses two primary indicators for portfolio quality: repayment rate and portfolio at risk.

The repayment rate is calculated as the total receipts for the month less pre-payments over the total amount expected for the month including arrears. Figure 1 shows the repayment rates for 1994–95, ranging from a low of 68.5 percent in April 1994 to a high of 92 percent in October 1995. It is not a coincidence that April 1994 was the low mark for GAFS during this period. This was the month of the historic elections, as well as the month that the stokvel program initiated its comprehensive reforms. Since November 1994, the repayment rate has hovered between 88 and 92 percent. Although the data for

[iii] For Get Ahead Foundation, the term "field staff," includes both loan officers and center managers. This is a logical approach given that managers are also expected to maintain a small portfolio, hence "loans per field staff" assesses the productivity of the entire field unit.

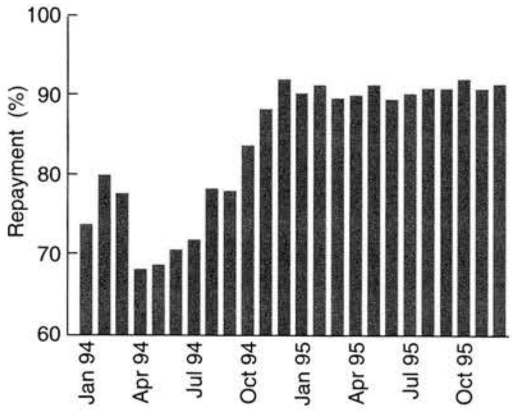

Figure 1. GAFS monthly repayment rates, 1994–95.

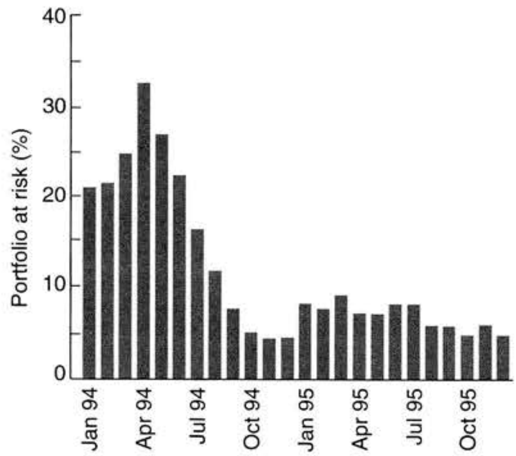

Figure 2. GAFS portfolio at risk, 1994–95.

the first half of 1996 are not included in figure 1, repayments continued to fluctuate within this range, reaching a low of 88 percent in March and a high of 92 percent in July. Get Ahead Foundation hopes to bring repayments closer to 95 percent on a consistent basis.

The second quality indicator is portfolio at risk. Get Ahead Foundation defines this as the outstanding balance of all loans in arrears (i.e., not paid at month end) divided by the total outstanding balance. The portfolio at risk is a mirror image of the repayment rate, with the poorest performance in April 1994 (32.5% at risk) and the best performances occurring at the end of each year (fig. 2). The improvements at year end are magnified by large disbursements that swell the denominator. Get Ahead Foundation would like to achieve 5 percent portfolio at risk on a consistent basis. In the first half of 1996, the portfolio at risk remained at about 9 percent, reaching a high of 11 percent in March and a low of 6.9 percent in July.

Sustainability

Measuring the sustainability of GAFS over the years is like trying to unwind a knotted ball of twine. The vast array of programs and projects that Get Ahead Foundation undertook, and the corresponding donors and their reporting requirements, has resulted in a complicated mess of financial statements and reports that do not produce useful or reliable data.

The first income statement for the Stokvel Lending Program was produced in March 1996. Even though the figures provide unsatisfactory sustainability ratios, the fact that the Get Ahead Foundation finally has statements for GAFS separate from the development activities is a major breakthrough. Unfortunately, figures for earlier years are not available, nor will they be. The finance manager has decided that it is not possible to break down records before 1996.

For the fiscal year 1995–96, GAFS covered only about 35 percent of its operational and financial costs through the revenue generated by its loan portfolio. Why was a client base of 10,000 borrowers not large enough to produce a self-sufficient operation? The main explanation lay in the fact that sustainability was not a goal for the institution until recently, and no efforts were made to

Table 6. Cross-country comparison of loan sizes and loan officer salaries, 1994–95).

Institution	Avg loan size (US$)	Loan officer base salary (US$)	Loan officer salary/loan size (%)	GDP per capita (US$)
BancoSol (Bolivia)	500	4,000	8.0	665
ADEMI (Dominican Rep.)	1,354	4,620	3.4	945
Get Ahead (South Africa)	225	6,800	30.2	2,764
ABA (Egypt)	730	528	0.7	700
TSPI (Philippines)	700	1,920	2.7	743

Source: Calmeadow.

cover costs. Having no financial statements was not a problem since no one was interested in the profitability of the institution.

The ratio of loan officer's salary to average loan size (table 6) presents another explanation for the low self-sufficiency ratio of GAFS. Get Ahead Foundation pays its loan officers more than the other programs in the sample, yet loans are several times smaller. However, staff salaries and incentives currently account for 54 percent of operating costs, which is low compared with other microfinance institutions. Christen et al (1994) found that in most of the best microfinance institutions, including BancoSol, Grameen Bank, and K-Rep, salaries represented 60 to 75 percent of total administrative expenses. This suggests that other direct costs of GAFS are also too high. Having 10 branches spread around the country contributes to increasing the costs of communication and monitoring.

Lessons Learned

The events at Get Ahead Foundation since the 1994 elections present some interesting lessons for the microfinance community. Most important, it is possible for established microfinance institutions to adjust to new directions and objectives. The process of adjustment will differ depending on the setting, but the foundation's experience suggests one possible route.

Stick to Basics

Get Ahead Foundation's decline and recovery emphasize the importance of adhering to the two basic tenets of microlending: the importance of excellent client service and strict delinquency manage-ment. Get Ahead Foundation also limited the array of services it offered, and GAFS has focused solely on providing financial services. This has helped clarify staff responsibilities, define the relationship between staff and client, and emphasize the importance of loan repayment.

Draw on the Best Practice

Although the initial design for the program drew on the conventional wisdom of group lending, the international microfinance community learned from experiences that were never incorporated into the program. After years of isolation, Get Ahead Foundation had to catch up in a short time. This was accomplished through access to technical assistance and by visits of senior management to leading programs around the world. Program exchanges, seminars, and technology sharing are critical in the rapidly advancing field of microfinance.

Because of aggressive affirmative action in South Africa, the foundation will probably continue to have a problem with senior management turnover. As an NGO, it cannot offer competitive senior management salaries. However, if the board of directors fully understood the principles of micro-lending, it would revise its views on this subject.

Business Approach to Lending

The Get Ahead Foundation experience underscores the importance of the mindset of the key participants. In the early 1990s, loan officers considered themselves social workers promoting economic justice, while their clients extended rent boycotts to the repayment of Get Ahead Foundation loans. Neither group realized that their attitudes could ultimately prevent the Stokvel Lending Program from providing important services in the community. Repeated messages from senior management regarding the importance of sustainability and timely repayments eventually caused staff, and subsequently clients to take the program more seriously. It is not easy, however, to change attitudes. Get Ahead Foundation is still struggling to weed out old, nonperforming clients, and old loan officers who are not prepared to operate under the new rules. It is much easier to begin with a business approach to lending than to adopt one mid-stream.

Leadership and Staff Participation

The case of Get Ahead Foundation demonstrates that dramatic improvements in a microfinance program are possible with the commitment of the organization's leaders. In 1993, the directors of the Get Ahead Foundation resolved to do whatever was necessary to remedy the situation, including hiring an experienced management team and seeking technical assistance from the international community. Without such a strong commitment, the current improvements would have been impossible.

The changes have been effective largely because staff were involved in the reform process. Although soliciting participation of middle management and loan officers has been time-consuming and often tedious, it has led to staff ownership, a critical element for sustainable implementation.

Managing Change

Get Ahead Foundation contracted the services of a consultant who facilitated and guided the reform process. This long-term, in-house consultant first conducted market research to learn what the foundation's borrowers wanted from the program and its products. Market research was followed by improved product design, staff workshops and training, and the modification of the information system. The consultant also conducted staff surveys before, during, and after instituting reforms to monitor staff morale and their understanding of the reform process. With someone dedicated solely to planning and implementing the reforms, the task team was able to introduce many changes in a short period without significantly interrupting the organization's work.

Timing is Everything

Most of the foundation's reforms were introduced weeks before the first all-race elections in April 1994. This timing worked to the foundation's advantage. The interventions created "the New Stokvel Program for the New South Africa." Through the training course, loan officers realized that the old procedures passed with the fall of apartheid, and the only way to save Get Ahead Foundation was to overhaul the program. Although the political environment in South Africa was unique, this link between institutional reform and external changes has wider implications. Organizations cannot dictate when external changes, like national elections, will occur, but they should consider the timing of their internal reforms in a broader context.

Incentives

Of the entire reform package, the task team believes that the most powerful element in changing staff behavior has been the incentive scheme. The incentive scheme motivated loan officers to achieve the proper mix of quality and quantity; it enhanced their awareness of performance levels; and it emphasized the organization's business approach to microenterprise development: the more income loan officers earn for Get Ahead, the more money they make for themselves. The incentive scheme was also introduced at a critical time in the reform process, which reduced the resistance to change.

Role of Donors

Like all South African NGOs, Get Ahead Foundation relied heavily on international donors during the apartheid era. After President Mandela's inauguration, many donors redirected their resources from the NGO community to the legitimate government. Not all donors had the foresight to ensure that organizations had alternative sources of income. Consequently, numerous South African NGOs have recently failed.

In the microcredit field, where organizations generate income by charging interest, donors have a responsibility to require recipients to reduce their reliance on external funding. In the case of the Get Ahead Foundation, USAID waited until 1994, 6 years after the organization began lending and 2 years after a scathing evaluation of the Stokvel Lending Program, before threatening to withdraw its support. It is not a coincidence that the foundation's most dramatic reforms occurred 1 month after USAID's threat to withdraw support, thus highlighting the critical role of donors in pushing microfinance organizations toward sustainability.

Remaining Challenges

The immediate challenges for GAFS fall into four categories: sustainability, leadership and governance, fraud prevention, and decentralization.

Sustainability

In 1996, performance projections were prepared by GAFS based on realistic growth assumptions of 32 percent a year on average (less than the 80% growth GAFS has experienced over the previous 3 years). The projections took into account a significant increase in the effective interest rate from 56 to 70 percent, which went into effect on October 1, 1996. With this increase and the projected 15 percent cost of capital (lower than it is now), GAFS should be able to generate a net profit by March 1999. Sustainability seems to be in sight, but it will require that GAFS manage its growth carefully and maintain a healthy loan portfolio.

Leadership and Governance

When Get Ahead Foundation was founded, its board of directors consisted of prominent African community leaders, including internationally known personalities. Although the composition of Get Ahead Foundation's board of directors was critical to the survival of the organization through the apartheid period, most board members have neither the time nor the expertise to lead the new GAFS to sustainability. In mid-1996, the boards of Get Ahead Development and GAFS were split, although there remains some overlap. GAFS recruited two new board members with strong financial backgrounds. The reconstituted board of

GAFS is now beginning to assume leadership responsibilities and intends to hold management accountable for specific performance criteria.

Over the past 5 years, three deputy managing directors left Get Ahead Foundation for higher salaries in the public or private sectors. Get Ahead Foundation has also lost several other senior managers. In fact, for years Get Ahead Foundation has been the training ground for South Africa's microfinance community. Former Get Ahead Foundation personnel now lead two other microfinance institutions (the Small Enterprise Foundation and the Women's Development Bank) and the government's microfinance wholesaler (Khula), while others are playing important roles in microfinance policy development in the Department of Trade and Industry. To become a sustainable financial institution, GAFS must find creative ways of retaining senior management.

Fraud Prevention

Get Ahead Foundation has a long history of problems with fraud, perpetrated primarily by loan officers and occasionally by head office staff. Most instances involved ghost groups; in some cases, loan officers told stokvels that their loan was rejected and kept the disbursement. Loan officers have also been known to roll repayments or up-front guarantees by depositing them several weeks after they were received.

To deal with this issue, GAFS is trying to eliminate completely the opportunities for loan officers to handle money. This works fairly well where the offices are close to banks and when clients pay on time. However, the repayment system is quite inefficient and tends to constrain the number of groups a loan officer can handle. GAFS may consider creating a less labor-intensive repayment procedure for groups that are on their third or fourth loan. Furthermore, the current repayment system does not work when the bank is far away, or when loan officers have to visit clients to collect repayments, or when clients want to pay after bank hours.

To eliminate ghost groups, GAFS requires center managers to meet with the group leaders prior to disbursements, but this does not occur consistently in the larger offices. Previously, Get Ahead Foundation had also appointed an internal auditor to monitor the implementation of fraud prevention strategies. However, his level of authority, his responsibilities, and his reporting lines were not clear. In a couple of instances, branch staff actually forced him to leave their offices. The internal auditor position was eliminated in 1996 during a series of cuts to reduce head office costs. GAFS needs to consider restoring this position after better defining its roles and responsibilities.

Decentralization

The success of decentralization depends on the ability of GAFS to improve its current MIS and to motivate staff to take on more responsibilities at the local level. These reforms are on the right track but it remains to be seen whether they will be effective in improving overall management of the institution.

The resurrection of Get Ahead Foundation's Stokvel Lending Program is still in its early days. Although portfolio quality has been restored, achieving efficiency, self-sufficiency, and financial stability are still major challenges. Regardless of the eventual outcome, the painful process of problem identification and reform provides an interesting experience for the microfinance community. The ultimate lesson from this experience is that programs should try to get it right from the beginning, but if that is not the case, all is not lost. With the proper mix of leadership, timing, technical assistance, and donor influence, dramatic change is possible.

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ZIMBABWE

Zambuko Trust

Peter Fidler and Mohini Malhotra

This case study presents a snapshot view (as of late 1995) of a dynamic and evolving process of institutional change and development. Zambuko Trust provides insights into the process of expansion of a microfinance institution from one to four provinces in Zimbabwe in just 4 years.

Background and Characteristics

Program History

The initial steps leading to the birth of Zambuko Trust occurred in 1990, when a group of influential Zimbabwean business, community and church leaders formed a board of trustees with the goal of establishing an organization to link the underprivileged with opportunities for enterprise and income generation. After securing assistance from a variety of sources (the most important was an NGO, Opportunity International), Zambuko Trust was established in 1992 as the first urban-based microfinance program in Zimbabwe.

Zambuko Trust is officially registered as two distinct legal entities. The first entity is a social welfare organization—a status that allows Zambuko Trust to receive grants without paying taxes. The second is a lending entity—a status that allows Zambuko Trust to charge interest on its loans.

Products and Methods

The terms of Zambuko Trust's loans and the lending methods it uses seem to be both appropriate for the clientele and advantageous for the institution as it marches down the road toward sustainability. In developing its financial products, Zambuko Trust management has combined flexibility with an appropriate blend of financial discipline.

Flexibility is provided in several ways. First, clients are given the opportunity to determine the necessary repayment period for their particular business from a 6- to 12-month timetable. Second, clients are allowed to chose whether they wish to apply for a loan using the group guarantee mechanism or a simple individual guarantor. Third, clients determine which household asset they would like to pledge as security for the loan. Finally, repayments can be made either at the Zambuko Trust office or at the client's place of business.

At the same time, Zambuko Trust has taken a number of prudent steps to ensure that its financial product can cover a sizable percentage of its costs. Among

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Table 1. Interest rate ranges on Zambuko Trust loans.

Loan size (Z$)	Effective interest (%)		Real effective interest (%)	
	6 months	12 months	6 months	12 months
500	73.0	52.5	40.7	24.0
1,000	67.0	49.5	35.8	21.5
2,000	64.0	48.0	33.3	20.3
5,000	60.2	46.1	30.2	18.8

these are the specification that a client lock into a specific repayment date each month, the requirement that all borrowers deposit 10 percent of their loan principal in an insurance fund prior to receiving their loan, the 3.5 to 4.5 percent processing fee that the institution charges, and the decision to charge above-commercial interest rates.

Interest Rate Policy

Zambuko Trust charges a nominal annual interest rate of 32 percent on all its loans.[1] However, given the additional fees the institution charges plus the fact that Zambuko Trust calculates interest on a flat rather than a declining basis, the effective rate of interest turns out to be much higher (table 1). Such high interest rates are in part a product of the inflationary environment in which Zambuko Trust operates. In September 1995, the official inflation rate in Zimbabwe was 23 percent. More important, however, Zambuko Trust's rates reflect a conscious recognition on the part of its management that to provide a sustainable flow of finance to the underclass in Zimbabwe's microenterprise sector, the institution must be financially viable and operationally self-sufficient.

Such a move was a brave step on the part of Zambuko Trust's founders and management. In the first year of Zambuko Trust's operation, a chorus of voices joined in criticism, claiming that microenterprise financing on commercial terms is nothing more than another form of exploiting the poor. But such an argument in favor of subsidized credit is tenable only if institutions are able to rely on a continued and limitless flow of concessional or grant funds—a scenario that is clearly not possible for Zambuko Trust. Although it has been criticized by government and members of the commercial financial sector for charging poor entrepreneurs above-market interest rates, the same criticism has not been voiced by its clients. The backlog in demand for Zambuko Trust loans illustrates that in Zimbabwe the cost of credit is not so much a constraint for microentrepreneurs as is mere access.

Turnaround Time

Zambuko Trust has been successful in limiting the time between loan application and disbursement. Since the majority of micro-loans are for working capital, speed is essential for borrowers, and delay tends to significantly raise the opportunity cost of borrowing. To reduce turnaround time, Zambuko Trust relies on solidarity groups to screen some clients and has decentralized the approval process for loans under Z$5,000 (98% of all loans).[2] For those loans, all that is required is an impromptu visit from a loan officer to the business premises, in order to recommend whether Zambuko Trust should finance the project, and a subsequent decision from the branch manager. As a result of the decentralized process, the turnaround time for

[1] Lowered from 35% in May 1995.

[2] The value of US$1.00 was Z$5.37 from Feb. to Dec. 1992; Z$6.25 from Jan. to Dec. 1993; Z$8.02 from Jan. to Aug. 1994; and Z$8.30 from Sept. 1994 to Aug. 1995.

Table 2. Growth indicators for Zambuko Trust, 1992–95.

Period	Loans (no.)	Clients (no.)	Total value of loans Z$000	US$000	Avg. loan size Z$	US$	Branch and satellite offices (no.)	Staff (no.)
2/92–12/92	269	269	449	84	1,669	310	1	7
1/93–12/93	452	419	819	131	1,812	291	2	11
1/94–8/94	1,193	1,037	1,670	208	1,400	175	4	19
9/94–8/95	2,786	2,197	4,257	501	1,528	180	7	42

loan requests is fast—most decisions are made within a week of the request.

Performance

Growth and Expansion

By late 1995, not yet even 4 years old, Zambuko Trust exhibited impressive rates of growth. In 1992, its first year of operations the institution made 269 loans worth Z$448,961 (US$83,600) (table 2). In 1995 the number of loans increased 10-fold, and the value of the institution's portfolio jumped by an equivalent amount. In FY 1995, Zambuko Trust disbursed almost 2,800 loans at a total value of Z$4.3 million (US$501,000). The institution has also expanded from a Harare-based credit program to an organization operating in four of Zimbabwe's eight provinces. In addition to branch offices in Harare, Bulawayo, Gweru, and Mutare, Zambuko Trust opened satellite offices in Chitungwiza, KweKwe, and Esigodini.

Scale of Market Coverage

Despite the rapid growth that Zambuko Trust experienced, it is evident that the Zimbabwean demand for working capital among micro and small enterprises is substantial, and Zambuko Trust has only begun to scratch the surface. A USAID study estimated that demand for working capital was around Z$638 million for over 168,000 microenterprises. It can therefore be estimated that in FY 1995 Zambuko Trust satisfied 0.7 percent of the value and just over 1.5 percent of the number of microentrepreneurs demanding microcredit.

Depth of Outreach

Zambuko Trust receives high marks for servicing some of the hardest-to-reach and poorest elements of the Zimbabwean population and enjoys the deepest outreach of any small-scale finance institution in Zimbabwe. Zambuko Trust clearly defines its clients as the economically active poor, i.e., those who are not employed in the formal sector, and the targeting criteria and lending methodology ensure outreach into these areas.

Zambuko Trust's average loan size for FY 1995 was Z$1,528 (US$180), and the average loan size was 33 percent of GDP

Table 3. Comparison of outreach indicators for Zambuko Trust and other institutions.

Institution	Avg. loan size (US$)	Avg. loan vs GNP per capita (%)	Women clients (%)
Zambuko Trust, Zimbabwe	180	33	70
Grameen Bank, Bangladesh	101	48	94
K-Rep, Kenya	217	64	60
BRI, Indonesia	494	81	24
BancoSol, Bolivia	535	82	70
ACEP, Senegal	1,106	135	20

per capita.[3] Only 2 percent of Zambuko Trust's loans have been over Z$5,000 (US$585). Table 3 illustrates that, compared with some of the world's most successful microfinance institutions, Zambuko Trust stands as a leader in reaching the least-advantaged segments of the economically active population.

Although the majority of Zambuko Trust's clients are literate, most have not received secondary education. Over 90 percent of Zambuko Trust's clients reside in urban or peri-urban areas, and approximately 70 percent of the clients are women. Although Zambuko Trust did not initially target women, by structuring its lending methodology and focusing its target group to reach the poor, the institution found that women composed a significant percentage of the portfolio. More recently, however, after reviewing repayment performance data, the institution has made a strategic decision to target women. As table 4 illustrates, Zambuko Trust management wisely concluded that women in the Zimbabwean informal sector tend to be better clients and show a greater commitment to honoring loan contracts.

Zambuko Trust is definitely reaching a segment of the market excluded from access to services available to those in the upper end of the formal sector. Its targeting by location (and by definition, race) and by gender allows it to reach into the lower ranks of the informal sector. Zambuko Trust clients receive few or no services (financial or other) from other public or private sources.

Table 4. Portfolio analysis by sex, Zambuko Trust.

	Loans (no.)	Loans (Z$ millions)	Arrears rate (%)
Women	1,950	2.6	18.1
Men	836	1.6	56.5
Total	2,786	4.3	30.6

Zambuko Trust's support is valued by its clients, who generally attribute improved cash flows and ability to make ends meet to the loan. The fact that half of the households in Zimbabwe depend solely on income from the microenterprise illustrates the importance of the service provided by Zambuko Trust and microfinance service providers in general at the household level. Moreover, it appears that Zambuko Trust is having an important demonstration impact on both attitudes and actions of government and the banking sector in support of the informal sector.

Quality of Service Provided

Zambuko Trust does not have empirical information on the impact of its activities on the living standards of its clients, but the anecdotal evidence is impressive. In informal surveys, clients usually responded that the loan had permitted them to earn more income, and a significant number reported that they had invested the additional income back into the business to promote enterprise growth. Moreover, the retention rate of Zambuko Trust's borrowers is high. Over 70 percent of the clients who obtained loans in FY 1994 took out follow-up loans in FY 1995. Finally, the fact that Zambuko Trust was forced to turn away new clients and freeze its lending level in early 1995, speaks to the valued service that Zambuko Trust provides.

Repayment Performance

In FY 1995 Zambuko Trust reported an impressive repayment performance of approximately 97 percent, implying that the institution eventually recovered 97 percent of all funds lent to its clients in

[3] The institution's maximum loan size of Z$25,000 (US$2,940) also serves as an insurance that Zambuko Trust remains committed to serving the poor.

that year. According to Zambuko Trust management, in 4 years of operations the loan default rate has never exceeded 4 percent.[4]

Although Zambuko Trust eventually recovers a large percentage of its loan funds, the institution's average arrears rate in FY 1995 reached 30.6 percent, a high level. Zambuko Trust is collecting on its loans, but a sizable share of its customers are late in repaying. Two aspects of the arrears rate are of particular concern to Zambuko Trust. First, almost 40 percent of the institution's arrears in FY 1995 were over 120 days past due. Second, the proportion of arrears has expanded as the institution has grown. In FY 1994 the average arrears rate stood at only 22.5 percent, just two-thirds of the FY 1995 level.

Zambuko Trust's arrearage problem does not seem to be the result of failures at the micro level. Zambuko Trust has developed a detailed method for loan officers to monitor their clients' loans, and in many ways the institution's strength is the loan officers' close connections with their clients. The volume of loans handled by each officer is also quite high. In FY 1995 it appears that Zambuko Trust's loan officers may have been asked to carry a bit too much of the burden. To reduce transaction costs, Zambuko Trust had been encouraging its loan officers to handle an average of 300 clients each. Realizing that 300 clients might be too many for each officer to handle without impacting the number of clients in arrears, Zambuko Trust is now asking its officers to handle no more than 250 clients each.

More than a performance problem, however, it appears that Zambuko Trust's arrearage problems have resulted from institutional and methodological shortcomings. First, Zambuko Trust suffers from inadequate reporting functions and a poor management information system (MIS). Zambuko Trust's management estimated that its arrears rate is actually overstated by approximately 15 percent because of a hypersensitive MIS in tracking arrears. Second, accounting for client repayment is often not uniform across branches. Although adjustments are made at headquarters, the process is costly both in staff time and in missed client payments. Finally, although Zambuko Trust does have an official policy for bad debt, in practice Zambuko Trust does not write off any loans. Given a ballooning effect with arrears, with Zambuko Trust collecting on a significant percentage of its loans once they are over 120 days past due, the institution needs to develop a bad-debt policy that better safeguards the portfolio against the problem of late payments.

Financial Performance

Although Zambuko Trust has chosen to price its financial product appropriately and views itself as a financial institution rather than as a social welfare organization, the institution still has a great deal of work ahead before it approaches financial viability. In FY 1995 total income collected from interest on loans, application and processing fees, and interest on savings and investment equaled Z$1.5 million. Total operational expenses—consisting of salary costs, administrative expenses, depreciation of fixed assets, and losses from loan defaults—equaled Z$2.5 million, yielding an operational self-sufficiency rating of 59.6 percent (table 5). The self-sufficiency rating in FY 1995 though up from its FY 1993 level was below that of FY 1994. These increased costs in large part reflect the significant expansion in the number of branches and staff incurred by Zambuko Trust in FY 1995.

Table 5. Measuring Zambuko Trust's operational self-sufficiency.

Fiscal year	Total income (Z$000)	Total expenses (Z$000)	Operational self-sufficiency (%)
93 (12 mo.)	345	738	46.8
94 (8 mo.)	524	752	69.7
95 (12 mo.)	1,513	2,536	59.6

Zambuko Trust has no financial costs since all of its funds are grants from its international donors. If subsidies on the institution's loan capital were to be eliminated, a theoretical cost of capital of 29 percent (the average commercial bank lending rate in Zimbabwe) would be applied against Zambuko Trust's loan fund. When such provisions are applied, the cost-recovery rate (i.e., interest income as a percentage of operating costs plus financial costs) becomes 43.0 percent in FY 1995, up from 37.7 percent in FY 1994. Zambuko Trust's subsidy dependence index was 239 percent for FY 1995, implying that the on-lending interest rate would have to be increased 239 percent to eliminate all subsidies and still break even. In other words, Zambuko Trust would have to increase its nominal interest rate from 32 percent to 76.4 percent to entirely end its subsidy dependence.

Zambuko Trust's growth has been impressive. Total assets have increased from Z$1.1 million at the end of FY 1993 to Z$4.7 million at the end of FY 1995. The institution's return on its assets was −10.8 percent in FY 1994 and −26.1 percent in FY 1995 (table 6). The low figure for FY 1995 reflects in part the low ratio of performing to nonperforming assets. At the end of FY 1995, less than 56 percent of Zambuko Trust's assets (i.e., loan portfolio or investments) could be classified as performing. Given the high percentage of nonperforming assets, it is not surprising Zambuko Trust's return ratio was so low.

Table 6. Return on assets, Zambuko Trust.

Fiscal year	Net operating income (Z$000)	Avg total assets (Z$000)	Return on assets (%)
94 (8 mo.)	−228	2,106	−10.8
95 (12 mo.)	−1,023	3,920	−26.1

Critical Issues

Zambuko Trust has built a solid foundation as the most effective and potentially viable microenterprise finance institution in Zimbabwe. In its first 4 years, Zambuko Trust expanded its scale of operations significantly and played an important role in bridging the gap between income generation and the underclass of Zimbabwe's economically active informal sector. Now that the institution's formative start-up and initial expansion phases have been completed, however, cost coverage and operational efficiency will receive additional attention. As Zambuko Trust strives toward self-sufficiency it will have to address a wide range of critical issues.

Governance issues

The Board of Trustees and the management need to develop clear lines of responsibility and roles. In the institution's first years, the board governed from a distance and was rarely involved in Zambuko Trust's day-to-day affairs. In response to a series of reporting problems, however, it appears that the board has over-reacted and in the past year has adopted a hands-on operational role. The board should be setting a coherent vision and performance standards for the management to achieve within defined periods.

[1] Zambuko Trust's default rate is calculated by taking the number of clients with expired terms (i.e., in arrears beyond the full term of their loan) as a percentage of total loans in the portfolio, as opposed to the more conventional method of calculating all loans 90 or 120 days past due.

Staffing

Zambuko Trust needs to change the ratio of administrative to field staff. Of Zambuko Trust's 44 staff members, only 13 are loan officers who directly generate income for the institution. The high ratio of administrative staff raises the operating costs of the institution relative to its revenue. Despite the overall staffing levels, loan officers are constrained in their ability to monitor clients as often as necessary, leading many to attribute high arrears to reduced monitoring.

Salaries

Zambuko Trust's salaries are not very competitive with equivalent jobs in the private sector. Management believes this problem is a major barrier to attracting highly skilled personnel. The institution has also found its trained staff subject to poaching by international NGOs, which are able to offer better compensation. Loan officer salaries average around Z$1,500 per month; loan officers in the commercial banking sector earn approximately three times that amount. The average annual staff salary at Zambuko Trust (including social security and bonuses) of Z$29,676 (US$3,500), while over six times the average GNP per capita in Zimbabwe, does not compare favorably with salaries in the private sector. The severity of the salary issue is compounded by the fact that Zambuko Trust already spends 82 percent of its operating income on salary expenses. Opportunity International, Zambuko Trust's strategic partner, is analyzing salaries in comparable institutions in Zimbabwe in order to arrive at a solution.

Strategy

Zambuko Trust needs to develop a strategic vision and plan, as well as measurable performance indicators to reach within a defined time. To date, it has been reacting to the inconsistent policies and requirements of its funding donors, rather than actively establishing a coherent and sound vision of what it wishes to achieve. Such a strategy would enable Zambuko Trust to better inform donors of how they can be of assistance to the institution.

Systems

Zambuko Trust opted for a strategy of rapid expansion, prior to consolidating its experience and establishing systems and infrastructure to handle the expansion. It is now (correctly) focusing on staff training and putting the infrastructure and systems in place prior to further expansion. Critical areas to focus on include:

- A standardized accounting system across the branch offices that consolidates the information and provides accurate and high quality data on the institution's financial position at the headquarters' level.
- Cost-accounting for the various services and special programs that Zambuko Trust operates. For example, there is no separate financial reporting for the Chitungwiza women's program—necessary to provide critical information to assess the methodology and the experience in relation to its costs. There is also no cost accounting for training services to microenterprise clients that is separated from the cost of delivering financial services.
- An improved management information system that generates the data to help management make key decisions in a timely fashion—data on arrears, loan portfolio quality, or client preferences for different services such as training, finance, etc.

Financial Management and Loan Portfolio Quality

Zambuko Trust's arrears are the most serious issue affecting the institution and its ability to achieve sustainability. The institution needs to send a powerful message that late payments are unacceptable, otherwise client repayment performance patterns will be difficult to reverse. Zambuko Trust staff blame arrears on many external factors—drought being the principal one. Arrears in most cases can be attributed to the methodology and the signal sent by the institution about the unacceptability of arrears. The danger to Zambuko Trust is that arrears are expanding as the institution scales up its loan operations.

Lending and Collection Methods

The level of arrears should prompt Zambuko Trust to reexamine its lending and collection policies. For example, Zambuko Trust lends to several members of the same household, with loan recipients responsible for guaranteeing other household member's loans. In effect, since most household income is pooled, a late payment by one member means that all other loan recipients are likely to be late as well. Also in the Chitungwiza Women's Program, Zambuko Trust should change its policy of requiring a woman client to get her husband's approval in order to get a loan, without requiring a man to get his spouse's approval. The policy should either be entirely dropped or applied to both men and women. Several women at a group meeting challenged the policy of having to inform their spouses of their loan, claiming that they had to hide money from their husbands who would otherwise use it for *lobola* (bride-price) to acquire more wives or spend it on drink. Others objected to their husbands getting loans without having to inform their wives, especially when the collateral for the loan included women's assets, e.g., jewelry, household pots, sewing machines, etc.

Loan Provisioning and Write-Off Policy

Zambuko Trust's loan provisioning and write-off policy are inadequate for the level of risk in the institution's portfolio. Zambuko Trust's reluctance to write off bad debt results in over-estimating the assets (size of the portfolio) and the future income stream of the institution.

Outreach

Zambuko Trust has made a strategic decision to increase its average loan size by 25 to 35 percent in FY 1996 to achieve its objective of becoming sustainable. Whenever a microfinance institution decides to raise its average loan size, it is important to consider whether the institution is departing from its commitment to reaching the poor. Moreover, it is important to ask whether the institution has other options it should pursue to meet its sustainability objective, such as reducing the level of arrears in the portfolio, increasing the scale of activity, reducing operating costs in proportion to performing assets, and re-examining some important aspects of its methodology.

For Zambuko Trust's, both options seem prudent. In 4 years of operation, the institution has lowered its average loan size (in real terms) every year in an attempt to scale down its financial product in favor of the underprivileged. However, because many of Zambuko Trust's clients have matured and their businesses have grown, the opposite effect should have occurred—Zambuko Trust's loan size should have increased. As a result, scaling up the average loan size would not only be prudent from the financial standpoint of the institution, but would also serve as a healthy reward to some of Zambuko Trust's most reliable and successful clients. Moreover, because Zambuko Trust management has elected to undergo a period of consolidation before any additional expansion takes place, increasing the average loan size should serve as a cost-effective way to increase the loan portfolio without incurring significant costs.

Training

Zambuko Trust currently provides an extensive free training program to all of its clients upon demand. It is estimated that 8 to 9 percent of all operating income is devoted to client training. While loan officers stressed that there is a significant difference in repayment performance between clients who attend training sessions and those who do not, Zambuko Trust also acknowledges that client training is costly to administer and represents a drain on limited resources. Zambuko Trust should, therefore, escalate its efforts to find a partner willing to take on the role of training delivery, so that it can concentrate solely on the provision of microfinance.

Supply of Loan Capital

In the first quarter of 1995, Zambuko Trust ran out of loan capital. That crisis provided the institution with an important lesson—so long as it remains dependent on donor funding, the scale of its operation is sure to remain limited. However, the institution is not ready to borrow money on commercial terms because it currently covers only 60 percent of its expenses without any cost to its capital. The issue of how to achieve greater independence from donor funding and create a sustainable flow of low-cost loan capital is one that Opportunity International is currently researching.

Savings Mobilization

Currently, Zambuko Trust does not have a voluntary savings component because its legal status prohibits the institution from accepting deposits. With the shortage in loan capital that Zambuko Trust currently faces, however, the institution is considering changing its legal status to obtain a relatively inexpensive and reliable way of increasing its capital base. Zambuko Trust should focus on consolidating its experience to date, addressing immediate critical issues, and building institutional capacity for its existing activities prior to embarking on mobilizing savings. As a long-term view, Zambuko Trust is appropriately thinking of mobilizing deposits, especially since many of Zambuko Trust's clients emphasized that they would rather park their savings in an institution that trusts them enough to lend to them.

Leadership

Finally, one of the most important issues affecting Zambuko Trust was the resignation of its executive director at the end of 1995. The executive director, who had been with Zambuko Trust since its foundation, was keenly aware of the issues highlighted above. In almost all cases, management had either begun to address the issue or planned to do so in the near future. However, with the loss of the executive director, the directions that the institution will take under new leadership remains an open question. To its credit, Zambuko Trust quickly found a replacement, avoiding a long vacancy at the top.

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ISBN 2-940200-05-X