Designing Microfinance from an Exit-Strategy Perspective

by Larry Hendricks

Abstract: In bilateral microfinance projects, exit strategies or “hand over” phases generally have not proven very successful. Institutions, groups, or processes designed with the sole purpose of implementing microfinance projects, to the exclusion of promoting postproject sustainability, tend to develop vulnerabilities that lead to their programs’ failure. To counter this problem, China’s Chongqing Comprehensive Poverty Alleviation Project (CCPAP) takes a different tack, designing an exit-strategy approach into its microfinance program from the outset. While still in the design phase, this approach has raised several critical issues that must be resolved, and these comprise the main focus of this paper.

Introduction

It is said that if you make a prenuptial agreement—an exit strategy—before you get married, you expect the marriage to fail. This may or may not be true in marriage. However, in many microfinance programs, past failures to build proper exit strategies into their designs from the onset have, arguably, caused problems.

Unlike some Non-Government Organization (NGO) projects, bilateral donor projects tend to have relatively short lives of four to five years. Therefore, the donors’ short-term involvement in the program and the short-term implementation of the project create limiting conditions and serious constraints, not faced by those who can take longer-term perspectives on
institution building. In its short four-to-five-year time frame, a bilateral donor project is expected to design a microfinance institution or program, to build the necessary capacity, and, when the project ends, to have established an operation that has developed enough momentum to achieve financial sustainability on its own.

That this tight time frame may pose challenges has been recognized elsewhere already. A recent U.S. Agency for International Development (USAID) evaluation of a business-focused NGO (2001) noted a need to bridge a development gap between building sufficient capacity and acknowledging evidence of conditions that must exist for a program to meet the needs of both development and secure investment standards.

This lesson was underlined recently in the Australian Agency for International Development’s (AusAID) Qinghai Community Development Project, implemented in China by Australian managing contractor Hassall and Associates International, where an end-of-project exit strategy was addressed only after two years of development. But as the subsequent evaluation, in its “Lessons Learned” section, stated, “the ultimate aim of a microfinance intervention is to ensure that after the donor’s withdrawal the microfinance organization created will become autonomous and capable of achieving financial self-sufficiency without further external assistance” (2001, Section 2.3).

Although the Qinghai Community Development Project had tried to establish a sound, long-term, sustainable microfinance model, its efforts were insufficient on several fronts. Its internal monitoring and governance structure was not institutionalized adequately to carry on after the project ended. Momentum built by the project during its life had created neither the necessary infrastructure nor a sound enough governance base to carry it across the aforementioned gap, so that it could operate at standards required to obtain a secure external

Larry Hendricks is microfinance specialist with CCPAP and senior consultant and manager of Henricks & Associates. Email: henricks@sympatico.ca
capital investment. As a result, a follow-on project had to be designed to assist the program to become sustainable.

When a subsequent AusAID effort, the Chongqing Comprehensive Poverty Alleviation Project (CCPAP), was modelled upon Qinghai, the original project design document likewise did not discuss implementing any exit strategy until the project’s last year. At that time the designers foresaw the need for a “hand over” phase. But in its proposal to AusAID, the same managing contractor, remembering the Qinghai experience, pointed out, “it will be important early in the project to develop an exit strategy.” This brief statement led the microfinance team to consider an entire new approach to the exit strategy in Chongqing.

**Background**

CCPAP is just getting underway under the auspices of AusAID. It is an integrated poverty alleviation project with components that include road and water system construction, income diversification, and microfinance. The project targets women in poor households, in poor villages, in poor townships in five national autonomous counties. All project components have a mandate for sustainability. For example, the road and water system construction component includes a mandate to train and prepare communities for the ongoing operation and maintenance of those systems. Income diversification training will prepare clients to use microfinance loans and to sustain new enterprises beyond the life of the project. The microfinance program has a mandate to ensure that it, itself, becomes sustainable and beyond that helps to sustain all other project interventions.

The Australian managing contractor, in attempting to implement the lessons learned in Qinghai and elsewhere in China, is applying these lessons rigorously to the development and operation of the CCPAP microfinance program in two ways.
First, the contractor is applying the lessons relating to microfinance by documenting how the application is taking place. Where the situation differs enough that a lesson cannot be applied as intended, an explanation of the differences is also being documented.

Second, and more pertinent here, is the exit strategy. Instead of waiting until nearly the end of the project to begin considering an exit strategy, the CCPAP microfinance program is, from the beginning, being designed and implemented in the sure knowledge that the project ends in four years. Unsurprisingly, this has already had a large impact on the program’s design, even though, at this writing, the microfinance program is less than two months into development. Already, the microfinance team has learned that it must address several lessons from the emerging issues. The most important of these are listed below.

**The Issues to Address**

A microfinance program cannot and should not count on a donor continuing to support it after the end of the project. That is, if a donor intended to continue support, it would have designed the project differently from the outset.

Considering a microfinance program’s design from an end-of-project perspective demonstrates the importance of filtering all design decisions, putting every element of the program to the following test: *Will this program continue to exist without project staff pushing it, and without project money to support it? Will it be sustainable in its own right?*

There are three major elements to every microfinance program, and each must be tested against this filter. They are (a) Management and Monitoring, (b) Management Information Systems (MIS), and (c) Field Delivery Resources. Each is addressed below in more detail.

Because CCPAP ends in four years, it is critical to assess each aspect of the microfinance program in terms of its contribution to sustainability. The consequence of applying this
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assessments filter to the design of a microfinance operation focuses more on other aspects of the program than on operational and financial sustainability. This filter adds several dimensions to the project’s design, one of which is to develop a local sense of ownership right from the outset, rather than waiting until the project’s last year to consider the hand over phase.

In an integrated poverty alleviation project, project team members must make hard decisions about which aspects of many project components contribute to microfinance sustainability. Participants must make a clear distinction between the outcomes of community participation, training, and income diversification activities, and the possible contributions of these outcomes to a sustainable exit-strategy-oriented microfinance program. This distinction becomes very important when groups formed at the village level begin to discuss income diversification. Should these groups also be given a role in the microfinance program? The exit-strategy approach dictates that the answer must be “no,” unless the groups pre-existed the project and could add value, for example, by adding the screening of loan applications to such work as they carry out already. Making decisions about such situations has the potential to put project team members at odds, unless communication between them remains open and active and unless all of them accept the need for sustainability in each of the three major program elements. Following are some factors affecting the decision process in Chongqing.

Management and Monitoring

In China, microfinance programs usually must work in partnership with organizations licensed by the People’s Bank of China, a requirement that creates simultaneous opportunities and challenges. On one hand, in China as in most countries, few commercial banks are interested in working with microfinance programs. On the other hand, if a microfinance program can prove itself to a commercial bank, bank enthusiasm and support may assist the microfinance program’s
marketing, reach, and sustainability. Also, if the bank recognizes the available marketing opportunity, it may use the microfinance program as a lever, to position itself to gain an edge in the increasingly competitive Chinese banking industry. Sometimes a combination of these circumstances may occur.

Analysis of other microfinance programs indicates that in most, the contractor or donor agency has controlled the management directly or formed a new board of management and controlled it indirectly. When forming a new board, participant selection is usually based on the local applicants’ positions relative to the project and so give more weight to officials in local government and projects. Once selected, this board of management theoretically is trained to manage the microfinance program. Unfortunately local participants often follow the project contractor or donor’s lead, and so never really learn to lead the program themselves.

From an exit-strategy perspective, this management approach is not viable. It severely limits the ability of a microfinance program to sustain itself after the project to establish it ends, in at least three ways. First, the contractor or donor disappears at the end of the project. Second, the financial support is no longer available and in most cases the value that a continuing successful microfinance program would have contributed does not exist or has not been cultivated enough. Third, if the board of management does continue, it has problems because it has gained no real experience leading the program.

Applying the sustainability filter to CCPAP’s design helped the microfinance team to determine that the project could not create a new board of management for the program, because its sustainability after the project ended could not be guaranteed. CCPAP therefore decided that it had to build on an existing local management structure and has made this approach a mainstay of the program’s design.

Instead of creating an entirely new board of management to act as a governing body, CCPAP chose to ask each
autonomous county government to nominate an existing local group already interested in poverty alleviation and microfinance. This strategy anticipates that the county Poverty Alleviation Leading Group will be nominated in each county. This county leading group, led by a vice-governor, currently is responsible for the local administration of China’s National Poverty Alleviation Fund Program. There is a risk that not all of these leading groups may comprise the best people. However, more importantly, it is likely that the groups will continue after the project ends, at least until the National Poverty Alleviation Fund Program winds down.

Besides administering the type of “best practices,” capacity-building exercise normal in similar projects with microfinance components, the contractor here recognizes that it must also train leading group members to acknowledge and accept three additional factors. The first of these is the benefit to the poor of a sustainable design for the CCPAP microfinance program rather than subsidized program. The second is that information yielded by high-quality microfinance performance data benefits board members’ everyday work in local government. The third is that a sustainable microfinance program can reduce poverty and make each participating county more competitive on national and international markets. Time will determine whether the third objective is achievable. However, CCPAP will make every effort to help translate its microfinance performance data into a form that can contribute to local development, reduce poverty, and increase local competitiveness.

**Management Information Systems (MIS)**

Many microfinance loan tracking and performance measurement software packages exist on the commercial market. Most meet the standards of the Consultative Group for Assisting the Poorest (CGAP) and are suitable for stand-alone microfinance programs.

As stated earlier, most bilateral microfinance projects in China must be implemented through a licensed organization.
As also stated earlier, CCPAP has decided that it must graft itself onto the existing structure of a licensed microfinance provider. Thus extensive participatory consultation with relevant stakeholders in each of the five counties where the project will operate led CCPAP to decide upon Rural Credit Cooperatives (RCCs), which are formal, licensed microfinance providers, as recipients of AusAID funds for on-lending. Where possible, CCPAP will use existing MIS and baseline information collected by these RCCs, not adding any new requirements unless a significant gap can be demonstrated in the information necessary for the CCPAP program. Existing performance reports will be used where possible. Any augmented reporting will be achieved by generating new reports on current RCC systems. This process allows the project to generate best-practice performance information and also to audit its program. In this way the project will enhance existing RCC systems, building on them to demonstrate how the same information accumulated for their entire current operations will both add value and contribute to more effective management overall.

With China entering the World Trade Organization (WTO), the People’s Bank of China is implementing a significant series of financial reforms. Consistent with the exit-strategy philosophy, CCPAP has determined that implementing Western accounting standards for its whole microfinance program would not be cost effective. Instead, except for the addition of installment-based delinquency reporting, Chinese accounting standards will be used. This will reduce confusion and will allow the normal course of financial-reform events to deal with other differences in accounting standards. The exit-strategy perspective dictates that any other approach would not be sustainable.

CCPAP’s project team believes that this approach should reduce costs in its own microfinance operation while building capacity in existing Chinese institutions. In any event, this method clearly holds more opportunity for long-term
sustainability than does instituting an MIS that would operate in parallel with the RCCs’ current banking and MIS systems. A stand-alone, specialized microfinance MIS could be easily discarded after CCPAP ends, but integrating performance reporting with existing local systems would make it less susceptible to abandonment.

Field Delivery Resources

RCCs have been recommended and accepted as the preferred licensed institutions for the microfinance program, partly because they have by far the most extensive township-level network of any Chinese financial institution. However, CCPAP’s planners had envisioned that the All China Women’s Federation (ACWF) would also play a significant role in the project. Assuming a solidarity group delivery model, part of that role would have involved the ACWF in the formation of borrowers’ groups. Difficulties with this approach include the ACWF’s small operating budget and consequently the very low salaries it pays to its village-level representatives. In fairness, if they were recruited by CCPAP, the program should also pay them for their services. Unfortunately, from an exit-strategy perspective, paying ACWF representatives to facilitate forming borrowers’ groups is not sustainable, especially compared with the more efficient approach of using the RCC’s extensive network. Because the project’s primary beneficiaries are women, this situation has caused CCPAP staff much concern. However, the project design provides for training and building capacity among ACWF representatives—the contractor team is exploring ways to help them become facilitators and to sell their services locally as community development consultants.

Skills with a repeat or referral market value that ACWF representatives could provide include the following: facilitating development of village plans; developing business plans; forming loan groups; selling their services for preparing loan applications, as literate people who know the microfinance system’s workings; mediating community and family conflicts; and
providing access to market information. The project microfinance team believes that if ACWF representatives are credible in the villages they represent, then charging small fees for their services outside their ACWF responsibilities will be acceptable. Such additional fees would supplement meager membership fees currently paid by households in these facilitators’ ACWF territories and so increase their incomes.

Helping ACWF village representatives become facilitators would solve the project’s group facilitation problem in a sustainable way and provide them with opportunities to improve their livelihoods as village facilitators, with potential to make significant favourable impacts on their communities’ marketing competitiveness.

CCPAP recognizes that it has based this proposed solution on three major assumptions. The first is that ACWF representatives would want to become facilitators. The second is that villagers would be willing to pay them extra for their new services, rather than considering these offerings as part of their ACWF jobs. The third is that the training CCPAP would provide them would be effective enough to raise their capacities and make their new skills saleable. Even recognizing these assumptions, however, the microfinance team thinks it best to try this innovative method to achieve sustainability. Not to do so would increase the project’s vulnerability to long-term failure, by increasing the likelihood that the basic foundations of the program’s structure could not be financed after the project was complete.

**Lessons and Conclusions**

The exit-strategy approach requires that the microfinance team undertake both a serious evaluation of what already exists onsite and an equally serious assessment of whether project involvement can be built upon an existing structure or process, to add evident value to that structure’s operation. These assessments must involve designing an effective capacity-building program that strengthens any existing provider’s operation.
Importantly, the exit-strategy approach also requires the team to gain a sound knowledge of the other components of a multi-faceted project such as CCPAP.

It is evident that single-purpose groups, such as boards of management created solely to implement projects, actually pose a threat to those projects’ sustainability. These created groups are, in reality, weak points that make microfinance programs vulnerable to collapse after the projects that have established them draw to an end. To counter this threat, CCPAP will establish a joint venture or strategic alliance between local governments and RCCs to deliver small loans to poor farmers interested in diversifying their incomes. The local governments form the boards of management and the RCCs are the program providers.

Most microfinance program designers think in terms of creating new stand-alone institutions. The consequences of adopting the exit-strategy approach are radically different. Instead of establishing a microfinance institution, CCPAP effectively uses microfinance principles to help the existing RCC institution establish a new product line with associated capacity, which it can market to current and future clients. This is a significant shift from current thought on microfinance. Consequently, some microfinance specialists are having difficulty grasping and accepting it as a workable alternative to the traditional microfinance institution.

However, CCPAP’s microfinance team feels that a properly rigorous evaluation of the situation leads straight to difficult decisions and to facing their consequences. Put another way, the only way to avoid making the hard decisions necessary to implement a good exit strategy is to avoid rigorous evaluation altogether. In the short term, avoiding these decisions would perhaps help team members avoid confrontations—but only to the long-term disadvantage of the program’s would-be beneficiaries. Thus, with the exit-strategy approach, the team cannot avoid hard decisions. However difficult, the Chongqing Comprehensive Poverty Alleviation Project’s team is making
the choices the approach demands. Time will prove whether its
decisions are correct and the approach is valid.

Notes

The views expressed are those of the author and do not represent those of
either Hassall & Associates International or AusAID.

1. In some ways this argument parallels the discussions among participants
in online microfinance discussion groups regarding the separation of micro-
finance operations from Business Development Service.

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