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Sustainable Integration of Microfinance and Education in Child Survival, Reproductive Health, and HIV/AIDS Prevention for the Poorest Entrepreneurs

by Christopher Dunford

Abstract: This paper provides diverse examples of microfinance institutions that have responded successfully to the challenge of integrating microfinance with nonfinancial services, without compromising the impacts or sustainability of their microfinance and overall operations. Special attention is given to the integration of microfinance with health education for very poor women, including the promotion of family planning and HIV/AIDS prevention management. The credit and education components reinforce each other by addressing the informational as well as the economic obstacles to health and nutrition. There is good potential for large-scale, self-financing delivery of microfinance and education together in one efficient and effective service package. The key element is delivery of both services by one field staff. This requires management to make an extra commitment to staff recruitment, training, and supervision. Where operating grants are available to support nonfinancial services, management may prefer to employ two specialized field staffs to deliver the two types of service in parallel to the same clients.
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Introduction

It is widely acknowledged that the very poor need more than microfinance to address the causes and conditions of their poverty. Ideally, the poor would have access to a coordinated combination of microfinance services and other development services to improve business, income and assets, health, nutrition, family planning, education of children, social support networks, and so on. The question is how to ensure a “coordinated combination” of appropriate services, especially in rural communities and other communities where multiple services are simply unavailable.

Microfinance practitioners are often motivated to provide nonfinancial services to their clients, because they recognize the need and hear the demand. However, the concern for sustainability, interpreted as the financial viability of the microfinance service as a business, has made practitioners very cautious about nonfinancial add-ons. They believe that add-ons can only be a drag on the drive for sustainability. Where other, nonfinancial service organizations can provide these add-ons for the same clients, some microfinance practitioners have fostered referrals and common points of service with their nonfinancial counterparts. But most microfinance institutions feel compelled or prefer to focus solely on the financial needs of their clients and do not attempt to meet their nonfinancial needs.

On the other hand, group-based microfinance provides a good opportunity to provide low-cost education services needed by the poor, if only to improve their performance as microfinance clients. This is especially true for village banking and related delivery systems that bring large groups of relatively poor clients together in regular meetings. Good, nonformal adult education techniques can be used effectively at the regular meetings to promote changes in personal behavior and

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in child-care practices and also to promote awareness of and confidence in whatever good quality health services are available locally. Such education technologies can also improve business skills that enable clients to put their loans to more productive use and generate more profit and savings. A variety of education topics can be covered effectively.

This paper provides diverse examples of microfinance institutions that have responded successfully to the challenge of integrating microfinance with education, without compromising the sustainability of their microfinance and overall operations. Special attention is given to the integration of microfinance with health education for very poor women. They and their children are very vulnerable to health and nutrition problems that threaten women’s abilities to contribute economically to their households, even families’ abilities to survive. There is also critical need for innovative integration of microfinance with promotion of family planning and HIV/AIDS prevention. Pioneering examples in Bolivia and Uganda are described.

### Integration Scenarios

In this paper, service “integration” refers to the coordinated delivery of different-sector services to the same people. There are three common scenarios for integrating microfinance with other services: **linked**, **parallel**, and **unified** delivery of different-sector services.

**Linked:** different organizations, different service delivery staff, same end users

Financial services are offered by a specialist microfinance institution at the same time as nonfinancial services (possibly for health and other sectors) are offered by one or more independent specialist or generalist organizations to the same people in need. When there are several development service providers in a target area (as in many urban and peri-urban areas), an organization reasonably may choose to specialize as a microfinance
business. Ideally, different organizations offering different services would coordinate their marketing, including delivery at common points of service and mutual referrals, as clients’ needs for other services arise. Many specialist microfinance institutions could embrace this scenario, but few reach for the “ideal” of coordinated marketing with nonfinancial service providers.

One long-standing example is the close coordination of BRAC’s Rural Development Program (RDP, a microfinance provider, described in more detail below) with Government of Bangladesh (and World Food Program) food distribution to the “hardcore” poor. The relationship is mediated by the Income Generation for Vulnerable Groups Development (IGVGD) program, jointly administered by BRAC and the Government of Bangladesh (CGAP, 2001). IGVGD links government food distribution to the very poor with a special BRAC effort to prepare destitute people for normal participation in the Rural Development Program. Otherwise, these people would not have even the minimal skills, resources, or opportunities required for participation.

**Parallel: same organization, different service delivery staff, same end users**

A generalist or multipurpose organization (often a grant-mobilizing local, national, or international private development organization) offers microfinance services through a specialist microfinance program staff at the same time as offering other sector services through different program staff of the same organization to the same people in need. If there are few available services in an area and an organization can afford a long-term commitment to provide two or more services with different specialist staff, then it makes sense to deliver a variety of complementary services in parallel.

BRAC again provides a good example. The RDP—the “normal” version to which IGVGD beneficiaries can graduate—serves 3.64 million members (97% women, mostly illiterate) with both financial and nonfinancial services to their village
organizations (VOs, composed of 7–8 solidarity groups of five members each). The financial services include four types of solidarity group loans: general (for whatever the borrower chooses and her solidarity group approves), program (to support particular activities promoted by other BRAC programs, such as poultry, silk culture, and social forestry), housing (to help VO members build homes), and rural enterprise (to set up nonfarm businesses in rural areas, such as small restaurants, grocery stores, laundries, and tailoring shops). The VO meets weekly with the program organizer (PO) responsible for credit—to collect savings (minimum of US$0.90 per week, earning 6% per annum, withdrawn only upon departure from VO membership), to decide who should get loans, and to make loan repayments. When a woman joins a VO, she must pay US$0.19 every year for a life insurance policy (the beneficiary of the policy receives US$93 in the event of the VO member’s death).

Nonfinancial services are provided by different POs, who also travel by bicycle to meet with the VOs and to see individual members. The social development POs provide general education at the monthly Gram Sobha (village meeting). This provides a forum where women can learn and gain information informally through discussion and consultation with other members and BRAC workers. Various socioeconomic, legal, health, and political issues are discussed (e.g., the need to prevent early marriages; how to stop domestic violence; how to prevent illegal divorces or bigamy; and where to access various types of services, such as immunization days). The social development PO is also responsible for offering new VO members “Human Rights and Legal Education.” This is a 30-day course conducted by a volunteer called the Shebika, a longstanding VO member given special legal training at one of the BRAC Training and Resource Centers and receiving US$0.37 per learner (half from the group member, the other half from BRAC).
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A third PO for health provides the “Essential Health Care” component of the RDP. This PO facilitates a monthly education forum in the community, for both VO and other community members, covering various health issues (e.g., local food sources of vitamin A, good nutrition during pregnancy and lactation, protection against six killer diseases through immunization, the use of slab-ring latrines, and the use of delivery kits for safe childbirth). Each meeting covers a new topic, has roughly 20 to 25 participants, and lasts for an average of 45 minutes to an hour. The health PO encourages learner discussion and participation with the help of community health volunteers (Shasthya Shebikas). Through the Shasthya Shebikas and the health POs, the RDP also provides prenatal and postnatal care at the community level and has established referral linkages with the basic and comprehensive Emergency Obstetric Care unit of the government.

The three types of PO report to different staff at the BRAC area offices, as well as at the head office. Within RDP, there are separate management sections for Microcredit, Health, and Social Development. Initially, all BRAC staff undergo a common training program for introduction to BRAC and its various programs, core values, and method of work. Subsequently, staff receive more specialized training which is directly relevant to their specific program work. Staff periodically get new training for new skills or to keep up with new developments within their field or within the organization.

The cost of BRAC’s credit program is calculated separately from the education and health programs. The total cost of delivering financial services includes all financial costs of capital lent to clients as well as all costs of external technical assistance. Based on financial performance in 2000, BRAC’s RDP credit program is projected to become completely financially self-sustainable in 2001. During year 2000, the credit program was actively expanding from 3.2 million to 3.64 million members, which lowered that year’s financial self-sufficiency ratio below 100%.
From the surpluses generated through the credit program and some of BRAC’s sector programs (such as poultry, silk culture, and social forestry) outside the RDP, BRAC is able to fund some of its educational programs. Still, at present, all the educational components of RDP are funded predominantly by external grants. To the extent possible, BRAC has started collecting service charges from its members for certain forms of education (e.g., the “Human Rights and Legal Education” course); however, all of the educational and training components are expected to rely partially for the foreseeable future on external funding.

**Unified: same organization, same service delivery staff, same end users**

The same staff of the same organization offers both microcredit and other sector services to the same people in need. When the people in need have access to few, if any, other development services, as in many rural communities, and the organization cannot afford a long-term commitment to provide two or more services with different specialist staff, it reasonably may choose to field only one set of staff tasked to provide microfinance with another service. The organization even may seek to hold its costs to a level it can sustain solely with revenue generated by the unified service itself.

Credit with Education providers are good examples. Credit with Education builds education onto a village banking platform. It comprises elements of the Grameen Bank, FINCA village banking, USAID-sponsored child survival programming, and principles of nonformal adult education. A more complete description of the model is provided by Vor der Bruegge Plas, Dunford, and Stack (1995).

FUCEC-Togo offers a specific example of Credit with Education in the institutional context of credit unions. This credit union federation and its member credit unions offer Credit with Education (Service Crédit-Epargne avec Education-CE/E) as one of several financial service products. Credit with Education gives the FUCEC-Togo credit unions
the opportunity for outreach to serve people that otherwise could not join a credit union, specifically poorer women in more remote rural communities.

Regular credit union members join as individuals by buying a share in the credit union and saving for a period of time before becoming eligible to receive loans in amounts geared to their savings on deposit. The membership as a whole has to be a “net saver” for this system to work without outside capital infusion. Excess liquidity in the credit unions is invested in the credit union federation’s central liquidity fund, from which member credit unions may borrow to manage cash flow.

FUCEC-Togo invests part of this central liquidity fund as loans to groups of women who cannot or will not join as individuals, because of the high cost of membership (shares are too expensive, they cannot save sufficient amounts to get needed loans, the nearest credit union is too far away, or credit unions are perceived to be for men). These groups are called Groupements d’Intérêt Economique et Social (GIES) and are composed of 18–30 (average 24) women, subdivided into solidarity groups of 4 to 7 women. These groups deposit savings in the credit unions in group accounts, but they are “net borrowers.” They join the credit union as a group and do not have the same rights as regular members to “one person, one vote” participation in the governance of their credit union, nor access to any financial services other than those delivered to the GIES.

A GIES meets in its own community with a FUCEC promatrice (field agent) for one to two hours each meeting—weekly for the first few loan cycles (16 weeks each), then biweekly as the group demonstrates its reliability. One promatrice meets with the group for the joint purposes of providing savings, credit, and educational services at the same meeting. The GIES are generally located in rural areas served by public transportation once in a week. Therefore, the promatrices travel to their meetings on motorcycles provided by the Service CE/E.
The promotrice helps the GIES register itself to receive the Service CE/E and provides orientation training in five two-hour weekly sessions. During the first few loan cycles, the promotrice tends to lead the meetings while encouraging members to participate. This leadership role becomes progressively a facilitating role for the more mature groups (advanced loan cycles), allowing the GIES management committee to take on their group leadership responsibilities. A successful field agent must ensure this transfer of responsibilities within three-to-six loan cycles.

FUCEC, the federation, hires, trains, and supervises the promotrices. Each is assigned to form and manage the GIES of two or more participating credit unions, which are too small in staff and service area to employ and supervise a full-time promotrice. Before assignment to a program area, the promotrice is provided two weeks of professional orientation to be well equipped to investigate villages to determine potential for the Service CE/E, to promote the program to rural women, and to form groups of women who want to join. The promotrice is trained in adult education and training techniques. The program trainer conducts most of the trainings, but for some specific trainings, the FUCEC program benefits from external assistance from Freedom from Hunger or PLAN International Togo.

The Service CE/E made its first loans in April 1996. The value of loans outstanding at December 31, 2000, was US$1,470,000 to 13,540 active borrowers (average loan size was US$109) in 550 GIES served by 21 promotrices. The credit union makes a loan to the GIES as a group. The GIES then lends to its members for any activity approved by their fellow members. The members are not required to borrow but 98% had loans at the end of 2000.

To receive education from the Service CE/E, women must be GIES members, attend the weekly or biweekly meetings, and be current savers. Topics covered deal with health and nutrition (diarrhea prevention and management, breastfeeding, infant and child feeding, and immunization and family planning),
better business development ("Increasing Your Sales" and "Knowing Your Real Profit") and GIES management.

Almost every GIES meeting (except when loans are disbursed by the promotrice or repaid in full by the group) includes a learning session. Each learning session takes about half an hour. Each topic, like family planning, requires several learning sessions spread over several meetings, generally concentrated in one "loan cycle" of a 16 week duration. Learning sessions are led by the promotrice with the assistance of the women in the groups. She uses short "dramas" and sometimes visual images to introduce the subject and various discussion facilitation methods to encourage everyone's contribution to develop and convey the key message. The sources of education materials and technical information, including updates and upgrades, have been Freedom from Hunger and the Togolese Ministry of Health.

The Service CE/E accounts for the costs of delivering financial and educational services together, because the two services are so unified in the work of program staff and their supervisors and trainers. As of the end of December 2000, income from credit operations covered 97% of the unified costs of the Service CE/E. Grant funding for start-ups in new areas has been provided by both PLAN International and Freedom from Hunger. Technical assistance funded externally (e.g., training by Freedom from Hunger) is not included as revenue or expense in the tracking of program costs. However, all these costs were included in a cost accounting analysis of the first three years of the program (Vor der Bruegge, Dickey, & Dunford, 1999). The three-year average percentage of total costs that could be attributed to the "extra education" (that which would not be provided by a standard village banking program) was 8%. While there is no comparable cost analysis for the year 2000, note that the costs of "extra education" are included in the calculation of the 97% operational self-sufficiency for the end of 2000.
Its experience with the Service CE/E has convinced FUCEC that education added to small loans and savings is essential for changing the lives of poor people in rural communities. Despite difficult economic conditions that limit the potential of their microenterprises, poor women have stayed with the program, according to FUCEC, because they enjoy fellowship with others and the information they receive during learning sessions. This has helped the financial self-sufficiency of the program as well as the women. In addition, FUCEC has become convinced that the financial and educational services can be efficiently and effectively delivered together by the same promotrices, who were serving an astounding average of 26 GIES each!

**A Hybrid Scenario of Unified Management and Parallel Delivery**

The example given for linked integration of services was actually a hybrid with the parallel scenario, because BRAC delivers financial and educational services in parallel and links both to food distribution provided by the Government of Bangladesh. PRO MUJER is a village banking provider in Bolivia that blends unified service delivery supervision with parallel delivery of financial and educational (and other) services by different field-level staff.

PRO MUJER delivers financial and nonfinancial services to peri-urban communal associations (CAs), which average 23 members (range 15 to 40), 98% of whom are women. Meetings are held every 7, 14, or 28 days, depending on the seniority of the group and the credit terms under which they operate. Each meeting lasts two hours, during which, according to the established agenda, there is an organizational stage, a payment session, and a training session (administration, business development, or health), in addition to a session for addressing various matters related to the activities of the group.

Members of a CA organize themselves into solidarity groups and elect a management committee and a credit committee to
facilitate administration, implementation, and control of resources and services provided by the communal association. Business and health managers are appointed to maintain the connections between the CA and services offered by PRO MUJER.

CA meetings are held in PRO MUJER focus centers; each CA has an assigned room. The health consultant and the office of Business Development are located in the same focus center, and clients have direct access to these services on their CA meeting days. Services are delivered by operating teams, each led by a credit officer/educator, who supervises all staff assistants providing services at a focus center. Credit assistants advise CAs on the evaluation, granting, and tracking of loans. Business assistants provide training and technical assistance for business development. Health Assistants provide preventive health training and primary health-care services. In addition, there is a business technician and a physician who give technical help to the personnel of these services and coordinate with the credit officer/educators, whose supervision is operational, not technical.

Business Development has two components. First, there is training given at the CA meetings, totaling 3-6 hours per loan term. These are motivational and informative sessions on business improvement and the development of business skills among participants. Second, there is technical assistance, consisting of individualized client consultations, beginning with a diagnostic of the business and establishment of a program of improvements to be gradually implemented. Finally, there are follow-up visits to adjust the recommended program.

The health service also has two components, both of which inform and guide clients regarding contraceptive methods, pregnancy and childbirth, and sexual transmitted diseases (STDs), including HIV/AIDS. First, there is both group training and individual counseling. The participatory group training sessions last for 30 minutes, with one topic per session. During each loan term, there are 3-6 hours of preventive
health training per CA. Individual counseling is provided by health service staff to women clients or couples.

The second component is primary health-care services, for which the health service provides consulting rooms and trained medical personnel. The health service organizes frequent screening campaigns for the early detection of breast and cervical cancer and STDs, so the patients can receive the appropriate treatment and follow-up. The health service coordinates its activities with other community health service organizations. Demand for information and services relating to HIV/AIDS is increasing. For contraceptive methods, the health service offers couples the opportunity to decide on a method and receive it in the same consultation. Couples deciding on a natural method receive orientation in its use and individualized follow-up to ensure correct use of the method.

As indicated above, staff assistants who work directly with clients are specialized in the service they deliver. Technical support is also specialized. On the other hand, the work of supervisory and middle-management personnel unifies all services at the focus center level and higher. With this model, each credit officer/educator can supervise 90 CAs (about 2,250 members) with three credit assistants and two nonfinancial service assistants (health and business development).

Fiscal years 1999 and 2000 were a period of rapid program service expansion—in 2000 alone, there was a net increase of 7,152 clients (to nearly 30,000 total), in both old and new service areas. Operational self-sufficiency, calculated only for the financial services cost center, correspondingly fell from 121% in 1998 to 95% in 1999 and 94% in 2000. Nonfinancial services represent 30% of costs during fiscal year 2000. Only 20% of costs for nonfinancial services were covered by income directly generated by these services. In the future it is planned that financial income and income from nonfinancial services will cover the costs of nonfinancial services. But, until this is achieved, PRO MUJER has sustainability plans based on contributions from the community, its own funds, and new
external financing. The sustainability of nonfinancial services is an institutional priority, because it “fully favors clients” and because it qualitatively strengthens and improves the performance of the credit service.

Integration with Family Planning and HIV/AIDS Programming

Integration with village banking, and similar forms of group-based lending, enhances the power of adult education in two ways. The regular group meetings are a good forum for adult education: they provide opportunities for regular face-to-face contact; the close-knit structure and joint guarantee mechanism foster a supportive atmosphere of collective self-interest; and women’s successful management of loans tends to build confidence and readiness to adopt new behaviors. Also, with interest income from credit operations, group-based lending can potentially fund the education activities at the regular group meetings, especially in the unified integration scenario. A financially sustainable, integrated delivery system can reach large numbers of the people, families, households, and communities most vulnerable to the problems addressed by the education.

Integrated service delivery strategies can and already do serve a wide variety of educational agendas. However, while there is growing interest, there is little documented experience in harnessing the potential of self-financing, integrated service delivery to address two of the greatest public health challenges of our time: family planning and HIV/AIDS prevention.

Multiple, closely spaced pregnancies and HIV infection pose widespread and serious challenges to individuals, families, and society, especially in developing countries. Not only are the health and economy of the poor affected, often disastrously, these problems pose threats to the not-so-poor, who are highly vulnerable to financial setbacks due to broken health and death in the family. Too-frequent child-bearing and -caring by poorly nourished women often result in high levels
of morbidity and mortality among mothers as well as infants and children. As HIV spreads relentlessly, adults in the prime of their productive and reproductive years grow ill and die due to HIV/AIDS or are dragged down by the unusual financial and time demands of illness and death in their extended families and their communities.

Microcredit institutions increasingly recognize their dependence on the health of their clients and their clients’ families. Many acknowledge the challenging circumstances for clients playing the triple roles of wife, mother, and businesswoman. Local public health officials confirm that much of the risk to clients and microcredit institutions alike could be greatly reduced with the use of effective family planning methods. In some countries, the HIV/AIDS epidemic is so severe that it threatens microcredit institutions through reduced loan portfolio growth, decreased client retention, increased portfolio delinquency, and increased drawdown from savings deposits, as well as the death of experienced staff or the burdens on them of caring for dying relatives. In such environments, many microcredit institutions are asking how they can better serve their clients. It is within the managerial and financial capability of many microcredit institutions to provide an education service that builds on the enhanced self-confidence of borrowers in order to promote the use of family planning methods, especially those that prevent the transmission of HIV, and other relevant, healthful values and practices.

In all the scenarios above, the microfinance institutions are offering education and even services relevant to reproductive health, including family planning and sexually-transmitted diseases like HIV/AIDS. PRO MUJER shows the greatest current commitment with its provision of both reproductive health education and clinical screening and counseling services. FUCEC-Togo joins most other Credit with Education providers in offering creative education and support for family planning.
BRAC’s Rural Development Program has decided to replicate a successful pilot project to make men and women in the communities aware of certain reproductive health issues. The project trained Shasthya Shebikas, traditional birth attendants, and traditional healers to provide, and discuss at people’s doorsteps, information related to sexually transmitted diseases, including HIV/AIDS, reproductive tract infection, sexual hygiene, and domestic violence. BRAC provided all these health workers with visual aids that were developed with great sensitivity to the fact that quite personal and sensitive issues were being addressed in a Muslim social environment. Prior advocacy work was done in the communities to explain the need and relevance of such discussion in the community, and the materials were shown to community leaders to ensure they did not object to any of the content. The project also trained the health workers to provide initial assistance and, as needed, to refer people to the appropriate care providers or government health facilities.

Unified integration of microfinance with nonfinancial services faces greater constraints than the linked and parallel scenarios. While interest income from group-based lending operations can potentially fund a number of extra activities at the regular group meetings, revenues from this high-volume, low-margin business can support only a very few activities. Only activities that can be managed by the regular field agent can be financially sustained solely by the financial margin from credit operations. In practice this means that only education, not services, can be provided and only in a limited number of education topics. This narrower range of possibilities is the price paid for greater potential for full operational self-sufficiency of the integrated package and therefore greater potential for large-scale outreach. Yet two Credit with Education providers are pushing the constraints of unified delivery to innovate in addressing needs for family planning and HIV/AIDS prevention and treatment: CRECER in Bolivia and FOCCAS Uganda.
Family Planning Education with Contraceptive Distribution in Bolivia

CRECER (Crédito con Educación Rural) is one of three poverty-lending microfinance institutions profiled by Gibbons and Meehan (2000). CRECER’s efficiency and sustainability ratios were comparable to, some better than, the other two institutions, which offered very little or no education in addition to financial services. At the end of 2000, CRECER’s operating self-sufficiency ratio (including interest on debt and loan-loss reserve) was 106%.

Like other Credit with Education providers, CRECER has restricted its nonfinancial services to group-based education, in order to minimize expenses beyond the costs of the village banking service. Providing additional services that require specialized staff and supplies can drive total program cost up sharply. However, with due regard for this caution, CRECER is now experimenting with a system for community-based distribution of contraceptives, because access to contraceptives is very limited for CRECER’s mostly rural clients.

One member is identified in the village bank to receive additional training about the use of certain contraceptives. Once trained, this woman is authorized as a community-based distributor (CBD) to sell approved contraceptives to appropriate customers in her community. Her stock of contraceptives is provided at cost by CRECER (which buys them at subsidized prices from local providers) and replenished by the field agent as the CBD sells her stock. Government health regulations limit the items in the CBD’s stock to condoms and vaginal spermicide. However, the CBD is given additional training that prepares her to offer counseling in the use of and contraindications for a broader range of methods that couples might want to consider. She is also linked to a local family planning service provider through a referral system. This referral system expands the range of methods the CBD can “offer” to clients.
Of 329 CBDs trained by September 2000, 260 remained active as CBDs in about one-third of the communities served by CRECER. A recent assessment of this CBD experiment found that CRECER trainers do conduct in-service workshops for the CBDs, that the CBDs do talk effectively and accurately about the methods they know, and that the CBDs do refer cases to the formal health system. The participatory education by CBDs appears to be desensitizing the topic of family planning and thereby creating a breakthrough in women’s willingness to talk about reproductive health issues. The assessment also found that CBDs are the leading sellers of contraceptives in the rural areas they serve. Even so, the volume of sales is very low, in part because the two types of contraceptives the CBDs can sell are in low demand (the spermicide tablets are preferred over condoms), despite the education provided. Nonetheless, the credibility of the CBDs as family planning educators seems to be enhanced by their ability to sell contraceptives and to counsel and refer people to good quality reproductive health services.

CRECER’s objective was to make the CBD system a self-financing service. The marginal costs of supporting CBDs amount to less than 0.5% of CRECER’s total operating expenses, but the low volume of sales and a government ceiling on contraceptive prices make it unlikely the CBD service can become financially self-sustaining. Nonetheless, motivated by its members’ response to the CBD service, CRECER is committed to bear the costs that cannot be covered through sales of contraceptives. Primarily external grants for this purpose, rather than the interest paid by all borrowers, is likely to be CRECER’s strategy to cover costs for the service that can directly benefit only a subset of CRECER members.

Education for Prevention and Management of HIV Infection in Uganda

FOCCAS Uganda (Foundation for Credit and Community Assistance) currently offers village banking together with health, nutrition, family planning, and better business education
to 13,048 women living (as of December 31, 2000) in rural and peri-urban areas of four districts of eastern Uganda.

Like CRECER, FOCCAS is providing family planning education to its women members and linking them to services provided by others. When the FOCCAS field agent has nearly completed the education module on family planning, field staff from Marie Stopes (a U.K.-based family planning support organization) attend the next regular group meeting. They again review the various family planning methods and answer any questions, with particular emphasis on the more technical aspects with which the FOCCAS field agents may be less conversant. They then provide access (on the spot) to any of the contraceptive methods that the women may have decided upon (including tubal ligation!). This is still a pilot effort, but it seems to go well, and Marie Stopes has committed to providing this service to any FOCCAS village bank that completes the FOCCAS family planning education module. This arrangement helps those women who are ready to take the next step, and it reinforces the messages that FOCCAS staff have been delivering.

Given the high prevalence of HIV/AIDS in Uganda, the need for FOCCAS to address the epidemic is a high priority. Both prevention and mitigation services are necessary, but FOCCAS could not realistically offer health care and other mitigation services while aiming to depend solely on revenues from its credit operations. Rather, FOCCAS choses to focus on HIV/AIDS prevention by providing FOCCAS members with the best available information and practical wisdom for reducing their risk of HIV exposure. The field agent also helps members think about HIV/AIDS in the context of the community, to better support those individuals dying of the disease and to encourage others to change their behavior to prevent new infection.

Having access to information does not ensure its use. The field agent must be prepared to address the reasons why women have not adopted or may not adopt beneficial new
practices. It is a real challenge to identify and respond to the major obstacles to behavior change in relation to HIV/AIDS. For example, how can a woman act upon her new understanding when she is often not given a choice regarding sexual intercourse? What should a woman do when she wants to have children but her husband indulges in high-risk behavior or is known to be HIV positive? The field agent facilitates a process of problem solving, decision making, and motivation to action that often involves a kind of psychological journey with a number of steps needed before making the decision to change ideas or practices and form new habits. Teaching and maintaining good group facilitation skills among field agents is central to successful behavior-change education. Fortunately, the training for group facilitation serves the microfinance component as well as the education component.

The proper selection of field staff and their training in facilitation skills and HIV/AIDS content is only the beginning. Also required are systems for (1) the supervision of education, (2) assessment and feedback on the quality of delivery, (3) monitoring the education impact, and (4) feedback from clients on the education content and quality. Such systems are available and complementary to the systems currently used by most microfinance institutions, but effort is required up front to adapt the systems, put them in place, and provide the necessary staff skills.

Although FOCCAS restricts its nonfinancial services to education, it recognizes that education alone is insufficient to properly address the HIV/AIDS crisis in eastern Uganda. In the near future, FOCCAS intends to facilitate member access to complementary HIV/AIDS services such as testing and counseling. This will require FOCCAS to identify appropriate local service providers, introduce members to these services, and maintain relationships with these providers.

Detailed examples of the educational methods and materials used by CRECER and FOCCAS are provided in annexes.
Parallel/Linked vs. Unified Service Delivery

In each of the cases described, the organization is committed to full financial self-sufficiency of the microfinance operations, but satisfying the broader needs of the clients is as important, it seems, as financial self-sufficiency of the overall institution. Where these organizations differ is in their deployment of managers and field staff. Only the Credit with Education providers—FUCEC-Togo, CRECER, and FOCCAS Uganda—are using the same managers and field agents to deliver both microfinance and nonfinancial services, and only they are coming close to full recovery (from the clients) of all costs for the full range of services. But BRAC and PRO MUJER, being willing to rely, in large part, on external funding, offer a broader range of services to their clients.

The advantages and disadvantages of the parallel (and linked) scenarios are:

- **Advantage**: wider potential range of services and therefore impacts for clients and society
- **Advantage**: staff can specialize by service sector and therefore be more expert in their work; greater effectiveness
- **Disadvantage**: financing of nonfinancial services depends on external grants; two or more staffs are required to provide services in two or more development sectors
- **Disadvantage**: coordination of staff (or organizations) representing different service sectors poses a significant challenge to management

The advantages and disadvantages of the unified scenario are:

- **Advantage**: potential for full cost recovery with income from credit operations; one staff can provide services in two or more development sectors
- **Disadvantage**: narrower potential range of services, mostly or entirely education
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- **Disadvantage**: recruitment, training, and supervision of multitasked field staff and supervisors demand extra commitment from management

In summary, the major challenge to the parallel scenario (where the same organization is responsible for parallel delivery of different services) is the sustainable financing of the non-financial service; whereas, the major challenge to the unified scenario is the management of field staff tasked to deliver different-sector services. It might appear that the linked scenario escapes both of these problems, and in theory it does. In practice, the linked scenario is very hard to maintain over time and over large service areas. Totally independent organizations have different missions, strategic plans, managers, and revenue sources. Those differences are likely to limit overlap in target populations and service areas and also to pull the organizations apart over time, ending the linkage agreement. The linked scenario in practice is the one least likely to reach major scale and be sustainable (but it works for BRAC and the Government of Bangladesh).

A microfinance institution considering delivery of additional services in nonfinancial service sectors should ask itself the following questions:

- What additional services are required by the institution’s own development objectives?
- What additional services are required to satisfy the needs and wants of the intended clientele?
- What are the feasible options for providing additional services that meet both institutional objectives and client objectives? Links to other, nonfinancial service providers? Creation of a separate institution to provide nonfinancial services? Creation of a separate nonfinancial service unit within the institution itself? Unification of the nonfinancial services with the existing financial service delivery system?

The unified delivery option is the most demanding, but it also may be the only option or the one most likely to be
sustainable in the long term. Even then, **unified delivery is advisable only when the institution wants to add one or more forms of education to microfinance services for relatively large borrower groups that meet regularly with field agents of the institution.**

The education should adhere to principles of effective adult learning, but the content can be varied or singular and drawn from structured curricula or facilitated exchanges of knowledge among the clients themselves. A mix of approaches (as in Credit with Education) can be used. But the education program, whatever it is, must be manageable by the same people, clients, and staff who are involved in the management of the financial services.

Smith and Jain (1999) have put forward the reasonable idea that the quality of either microcredit or education must be compromised for the sake of unified delivery. In other words, the efficiency and effectiveness of services is diminished (and impact is compromised) when delivered by multitasked generalists rather than by focused specialists.

In contrast, Freedom from Hunger has done considerable research, especially the studies conducted in Ghana and Bolivia (McNelly and Dunford, 1998, 1999), to verify that Credit with Education is having the intended impacts in three areas: improved economic capacity of women, empowerment of women, and adoption of key child survival health and nutrition practices that lead to measurable change in food security and nutritional status. Other impact studies (including those by or for BRAC, FUCEC-Togo, and PRO MUJER) yield similar findings. Impact studies for microfinance-only programs have shown results similar to those found in studies for Credit with Education programs. The addition of health and nutrition education does not appear to keep village banking from producing the significant economic and empowerment impacts sought in microfinance programming. Likewise, impact studies for stand-alone health and nutrition education programs show results similar to those found in the impact studies for Credit...
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with Education programs. Therefore, it seems the education in Credit with Education can be as effective in stimulating health and nutrition behavior change.

Is the unified, self-financing scenario possible? Is it feasible? Is it effective? The answers appear to be “yes” to all three questions when applied to certain types of microfinance and certain types of education delivered together. Integration is only for those whose objectives call for providing multisectoral services to address multiple needs/wants of the very poor. Unified integration is only for those with the need and the will to lead and manage staff toward long-term independence from operating grants. As an organization considers the unified option, it should understand why this option is more demanding and be realistic in assessing its commitment.

Notes

Portions of this paper are based on drafts by Barbara McNelly, Christian Loupeda, Beth Porter, Bob Richards, Kathleen Stack, Didier Thys, and Ellen Vor der Bruegge of Freedom from Hunger and by staff of BRAC, FUCEC-Togo, and PRO MUJER. This is a condensed version of a paper commissioned to further the Microcredit Summit Campaign’s learning agenda. The full paper, with detailed case studies of BRAC (Bangladesh), FUCEC-Togo, and PRO MUJER (Bolivia), may be found at the Microcredit Summit Website: http://www.microcreditsummit.org/papers/healthintro.htm.

1. Each Credit with Education practitioner develops its own operational system for self-financing, unified delivery of microfinance and education to poor women. Credit with Education was first developed by Freedom from Hunger in 1989-90 for the purpose of improving household food security and child nutrition. As of June 30, 2001, Freedom from Hunger had assisted NGOs and community-based financial institutions in 15 countries to start their own Credit with Education programs. In aggregate, these implementing organizations were reaching 189,540 women, of whom 153,733 were taking current loans averaging $73 each. The total amount of outstanding loans was US$11.2 million, and the total amount of savings was US$2.6 million. The weighted average for operating self-sufficiency, of the implementing organizations reporting complete revenue and expenditure data for the previous six months, was 92%. Overall portfolio at risk was 3.86%. Other versions of Credit with Education have been developed by other organizations in the past decade without Freedom from Hunger assistance, notably by World Relief Corporation and Project HOPE.
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Seven Aspects of Loan Size

by Mark Schreiner

Abstract: Attempts to measure the depth of outreach in microfinance usually start—and often end—with loan size. But just what is loan size? This paper discusses seven aspects of loan size, each of which affects not only depth of outreach but also profitability. The seven aspects are: term to maturity, dollars disbursed, average balance, dollars per installment, time between installments, number of installments, and “dollar-years of borrowed resources.” This paper defines the seven aspects, explains why each one matters, and gives examples of their measurement with data from three Latin American microfinance organizations.

Introduction

Ten years ago, self-sustainability was measured with the Subsidy Dependence Index (Yaron, 1992). Now, grades and shades of self-sustainability are recognized, and the SDI is complemented by such measures as Adjusted Return on Assets, Financial Self-sufficiency, and Net Present Cost (Christen, 1997; Schreiner, 1997).

In the same way, depth of outreach has been measured mostly as loan size, usually as dollars disbursed or average balance. But both borrowers and lenders also care about many other aspects of loan size. In addition to dollars disbursed and average balance, this paper defines the following aspects and discusses how they affect outreach and profitability: term to maturity, dollars per installment, time between installments, number of installments, and “dollar-years of borrowed resources.”

Each of the seven measures highlights one or more dimensions of loans but ignores other dimensions. Thus, loans may be “large” in some senses but “small” in others. Compared with
knowledge of one aspect of loan size, knowledge of all aspects can lead to markedly different choices.

The aspect most often ignored is probably term to maturity. For example, donors often take the amount disbursed as a marker of depth of outreach. Gonzalez-Vega, Meyer, Rodriguez-Meza, and Navajas (1997) find, however, that while growth in the amount disbursed had slowed for a group of large, mature microfinance organizations in Bolivia, growth in the term to maturity continued. The microlenders increased loan size not by disbursing more per loan but by lengthening terms to maturity. Looking only at amount disbursed, donors would mistakenly have viewed depth of outreach as unchanged rather than decreased.

Likewise, microfinance loans (for example, for the purchase of a fixed asset such as a sewing machine) may differ in term to maturity. Compared with a 2-year loan, a 1-year loan is typically equivalent in amount disbursed, in average balance, and in time between installments; larger in dollars per installment; and smaller in term to maturity, in number of installments, and in “dollar-years of borrowed resources.”

Whether a given loan is seen as “large” or “small” depends on which aspects matter most from a given point of view. Borrowers concerned mostly about low monthly payments will see a 2-year loan as smaller than a 1-year loan; borrowers concerned mostly with getting enough cash to make a purchase will see both loans as equivalent; and borrowers concerned mostly with interest costs will see the 30-year loan as larger than the 15-year loan.

The best measures of loan size encompass multiple dimensions. In particular, the measure of “dollar-years of borrowed resources” encompasses all six other aspects. Although virtually unknown and unused to date, “dollar-years of borrowed resources” probably should be the preferred summary measure.

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of loan size. In simple terms, “dollar-years of borrowed resources” is the average balance that would obtain if the loan had a term to maturity of one year.

The rest of this paper defines and explains each of the seven aspects of loan size. It explains the importance of each aspect in terms of depth of outreach and profitability, and it defines formulae for their measurement. Examples of all of the measures are drawn from three large Latin American microfinance organizations. The examples not only show how to compute the measures but they also show that, compared with looking at a single aspect such as amount disbursed, looking at all seven aspects can lead to different conclusions. Finance is the exchange of resources through time; measures of loan size should account explicitly for the passage of time.

To illustrate the measurement of loan size given data generally available to external analysts, Table 1 computes measures of the seven aspects of loan size for three large, broadly targeted microfinance organizations in Latin America.

Figure 1 depicts the seven aspects of loan size for a loan repaid in equal installments. The vertical axis marks cash flows, with positive flows going from the lender to the borrower and negative flows going from the borrower to the lender. The horizontal axis marks time. For simplicity, interest is ignored. Figure 2 depicts typical loans in 1995 from two of the example microfinance lenders from Latin America.

**Term to Maturity**

In Figure 1, term is measured along the horizontal axis. All else constant, longer loans are larger than shorter ones. For lenders, longer loans generate more interest revenue from a single evaluation and disbursement. On the other hand, longer loans have more chances to fall into arrears and may lead to greater delinquency costs.

For borrowers, longer loans signal shallower outreach because the most creditworthy—and hence the least-poor—usually get the longest loans (Conning, 1998). Term also matters
because lenders usually allow borrowers only one loan at a time. Thus, if borrowers use loans to pay for periodic purchases—for example, monthly additions to inventory—shorter terms would be more valuable than longer terms. On the other hand, if loans purchase fixed assets whose returns take longer to realize, longer terms would be more valuable both because such fixed-asset purchases are infrequent and because longer terms better match the size and timing of installments with the size and timing of returns from the fixed asset.

In general, longer loans signal greater profitability but less depth of outreach.

**Formulae**

The most accurate way to compute average term to maturity uses data on each loan outstanding at a point in time or on each loan disbursed in a year. External analysts, however, usually do not have access to such data. A proxy measure for average term to maturity (in months) that uses commonly-available data is:

\[
\text{Term to maturity} = 12 \left( \frac{\text{Annual average number of loans outstanding}}{\text{Number of loans disbursed in year}} \right) \tag{1}
\]

This estimate is based on numbers of loans outstanding and numbers of loans disbursed. An alternative estimate is based on value outstanding and value disbursed:

\[
\text{Term to maturity} = 12 \left( \frac{\text{Annual average value outstanding}}{\text{Value disbursed in year}} \right) \tag{2}
\]

Both equations 1 and 2 understate the true average term in a growing portfolio, but the bias is small. To measure term to maturity in years rather than months, remove the multiplicative factor of 12 from the formulae.
Example
For the three Latin American lenders, the average term based on the number of loans is 4.0 months for lender A, 5.3 months for lender B, and 6.2 months for lender C (Table 1, line c). In contrast, the estimates based on dollars loaned is 3.2 months, 4.1 months, and 5.9 months (line f). (Comparisons could also focus on changes through time for a single given lender rather than differences across lenders.)

With term to maturity measured from loan values, lender C makes loans that are \(\frac{5.9 - 4.1}{4.1} = 44\%\) larger than lender B and 84\% larger than lender A. In contrast, when loan size is measured as amount disbursed, the differences are only 3\% and 38\% (Table 1, line g). For these three microlenders, differences in depth of outreach and profitability due to loan size are much larger when seen as term to maturity than when seen as amount disbursed. Accounting explicitly for time-via term to maturity-matters for the measurement of loan size.

Dollars Disbursed
Dollars disbursed is the most common measure of loan size. In Figure 1, dollars disbursed is measured along the vertical axis. This measure ignores time.

For borrowers, dollars disbursed matters because it represents the largest single purchase possible from loan proceeds. For example, a farmer who wants to buy a cow that sells for $100 has little use for a disbursement of only $60 unless she can make up the $40 difference from other sources. Dollars disbursed also represents the addition to overall household liquidity provided by the loan.

For lenders, dollars disbursed affects operational costs and profits in two ways. First, the disbursement is the maximum possible loss due to default. Second, although most of the costs of evaluation and disbursement are fixed, larger loans do have higher per-dollar variable costs because lenders take extra care due to greater risk exposure.
From the standpoint of depth of outreach, smaller disbursements imply greater average depth if poorer borrowers are riskier and so qualify only for smaller loans. Furthermore, poorer borrowers have fewer complementary assets to combine in production with the large, lumpy assets that might be purchased with a large disbursement. For example, a farmer with two hectares of land is unlikely to use a disbursement to buy a tractor. Thus, poorer borrowers are more likely to want smaller loans than less-poor borrowers.

In general, larger disbursements mean more profits but less depth of outreach.

Formula
Given the aggregate annual data usually available to external analysts, the formula for the amount disbursed is:

\[
\text{Amount disbursed} = \frac{\text{Dollars disbursed in year}}{\text{Number of loans disbursed in year}}. \tag{3}
\]

Example
Average disbursements in 1995 by the Latin American lenders were $494 for lender A, $658 for lender B, and $681 for lender C (Table 1, line g). As noted above, lender C disbursed 3% more than lender B and 38% more than lender A.

International Comparisons
Cross-country comparisons of loan size often attempt to account for different levels of income by dividing average dollars disbursed by per-capita annual GNP:

\[
\text{Average dollars disbursed} \quad \frac{\text{Per-capita annual GNP}}{\text{Per-capita annual GNP}}. \tag{4}
\]

In 1995, annual per-capital GNP in the country of the three Latin American lenders was about $900. As a share of average dollars disbursed, per-capita GNP was 0.55 for lender A, 0.73 for lender B, and 0.76 for lender C (Table 1, line i).
Because the lenders are in the same country, normalizing by per-capita annual GNP does not change their relationships. In general, however, normalization changes the rankings.

As a benchmark for depth of outreach, this ratio has two weaknesses. First, per-capita GNP typically exceeds both median GNP and the poverty-line income because a few very rich people pull the average up. Thus, although the ratios are useful for relative comparisons across countries with similar income distributions, they are not useful if the income distribution differs. Furthermore, the ratios are not good benchmarks of absolute depth of outreach, whether across countries or within a country. An alternative might compare dollars disbursed with poverty-line income, perhaps adjusted for purchasing-power parity. The standards used to set the poverty line differ across countries, however, so median income might be a better benchmark. Unfortunately, data on median income are difficult to come by.

A second weakness of the ratio of dollars disbursed to per-capita GNP is its lack of a useful interpretation: the numerator is the flow disbursed as a loan, while the denominator is the flow from average income in a year. The two flows pertain to different time frames.

An alternative ratio compares cash inflows in a common time frame, cash inflows from loans in a year with cash inflows from income in a year:

\[
\left( \frac{\text{Average dollars disbursed}}{\text{Per-capita annual GNP}} \right) \left( \frac{12}{\text{Average term to maturity}} \right) \tag{5}
\]

Of course, cash from income, unlike cash from loans, does not need to be repaid. Still, this ratio is sensible because it compares annual flows with annual flows. In short, it accounts for time.

For the three example microlenders, this ratio was 1.6 for lender A, 1.7 for lender B, and 1.5 for lender C (Table 1, line 3).
j). Although lender C had the largest average dollars disbursed, the longest average term, and—as shown below—the second-largest average balance, its loans provided smaller cash inflows to repeat borrowers through time. This point of view is particularly relevant because the typical microfinance borrower takes several consecutive loans through time.

This new ratio also has another interpretation. It suggests that, compared with self-finance from savings, access to these example lenders allows borrowers to make investments that otherwise would have required saving 1.5 to 1.7 years of the typical per-capita income. Even assuming savings of 25% of income, access to loans allowed investments, all else constant, 6 to 7 years sooner than under self-finance.

**Average Balance**

Average balance is the second-most common measure of loan size, mostly because it is simple to compute from readily available data. The right-hand side of Figure 1 shows the average balance as a vertical distance. Average balance measures the level of resources typically held in the term of the loan, without consideration for the length of the term to maturity.

For a borrower, average balance measures the resources typically provided by the loan during its term. Of course, this is also the typical debt burden, so, all else constant, poorer borrowers probably have smaller average balances.

For a lender, revenue (and default risk) are directly proportional to average balance. All else constant, loans with larger average balances are more profitable but are associated with less depth of outreach.

But not all else is constant. In particular, the average balance depends on the term to maturity and on the size, timing, and number of installments. For example, the average balance of a balloon loan with one repayment equals the amount disbursed, but the average balance of a loan repaid in equal installments is slightly more than half the amount disbursed (Rosenberg, 1999). Furthermore, a loan repaid in four weekly installments has
about the same average balance as a loan repaid in four monthly installments. Average balance ignores term to maturity (and other aspects of loan size), so it is an imperfect measure.

**Formulae**

\[
\text{Average balance} = \frac{\text{Dollars outstanding at year-end}}{\text{Number of loans outstanding at year-end}}.
\]  

(6)

The average balance may be computed from publicly available data as the ratio of stocks at a point in time (usually year-end):

This stock measure is susceptible to seasonality, and if a portfolio has grown rapidly, then it also can overstate the average balance of the average loan during the year. A ratio of annual averages avoids these issues:

\[
\text{Average balance} = \frac{\text{Annual average value outstanding}}{\text{Annual average number of loans outstanding}}.
\]  

(7)

Which formula is most appropriate depends on data availability (year-end stocks are easier to obtain than annual averages) and on the question the measurement intends to inform. For a snapshot of the portfolio at a point in time, stocks are best; for a summary picture through a year, annual averages are best.

**Examples**

All three Latin American lenders grew rapidly in 1995, so year-end stocks (Table 1, lines k and l) exceed annual averages (lines a and d) from monthly data. The choice of formula (equation 6 versus 7) matters for comparisons among lenders; average balances computed from annual averages are smaller, compared with average balances computed from year-end stocks, for lender A ($388 to $440, lines m and n) and for lender B ($516 to $614), but larger for lender C ($656 to $562), probably
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because a sharp seasonal spike in small loans to traders at Christmas distorts the stock measure.

Average balance can provide a different picture of loan size than amount disbursed. Although lender C had larger amounts disbursed than B and A, if average balance is measured with annual averages, then lender B ($614) had larger loans than lender C ($562). The relationships differ even if average balance is measured with stocks: in this case, C is 27% larger than B (rather than 3% for amount disbursed) and 69% larger than A (rather than 38%).

International Comparisons

For cross-country comparisons, common practice is to divide average balance by per-capita annual GNP:

$$\frac{\text{Average balance}}{\text{Per-capita annual GNP}}$$ (8)

For lenders A, B, and C, this ratio was 0.43, 0.57, and 0.73 (Table 1, line 0). But what exactly do these shares mean? Besides the weaknesses of per-capita GNP as a benchmark for depth of outreach that have already been discussed, the interpretation of the ratio is unclear because the numerator has units of resources borrowed per loan but the denominator has units of income per year.

An alternative ratio would compare dollar-years of resources provided by a loan to dollar-years of resources provided by income, if all income were saved. This ratio uses the concept of dollar-years of resources. A dollar-year of resources is a dollar's worth of resource held for twelve months, or, equivalently, twelve dollar's worth of resources held for one month, or six dollar's worth of resources held for two months, etc.

If income flows into a household in a constant stream and if all income is saved in a year, then the resulting dollar-years are half the total annual flow of income (that is, per-capita annual GNP ÷ 2). The dollar-years provided by loans in a year—assuming repaid loans are renewed with identical loans—
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is the average balance multiplied by the number of loans in a year. Thus, the proposed alternative ratio compares dollar-years of resources from loans with dollar-years of resources from annual income, if it were all saved:

$$\frac{\text{Average balance} \left( \frac{12}{\text{Average term to maturity}} \right)}{\text{Per-capita annual GNP} \div 2}$$

(9)

As seen by this summary ratio, loan size was about the same for lenders A and B (2.6, Table 1, line p) and about 8% larger for lender C (2.8). This near sameness contrasts with the much larger differences found through the lens of amount disbursed, term to maturity, and average balance. Again, the difference results from a more complete consideration of the passage of time.

**Time between Installments**

Loan size increases with time between installments, the horizontal distance between steps in Figure 1. Obviously, this measure directly accounts for time.

For borrowers, more-frequent installments increase costs because, with less time to accumulate cash for repayment, the likelihood increases that net cash flows will be unusually low. For example, a street vendor has more bad days than bad weeks, so daily installments are more likely to be late than weekly installments or monthly installments. Also, more-frequent installments imply greater transaction costs to actually make payments. Poorer borrowers are less able to absorb these costs.

For lenders, frequent installments affect costs (and thus profits) in three ways. First, costs increase because borrowers fall into arrears more often and thus must be dunned more. Second, costs increase because of the need to process frequent payments. Third, costs decrease because—all else constant—unusually risky borrowers are more likely to fall into arrears.
and draw attention to themselves before they have severe repayment problems.

In general, more time between installments implies less depth of outreach and both positive and negative effects on profits.

**Formula**
The ideal way to measure the frequency of installments is with data on each loan outstanding at a point in time or on each loan disbursed in a year. If the average number of installments is known, then one alternative is:

\[
\text{Frequency of installments} = \frac{\text{Average term to maturity}}{\text{Average number of installments}}
\] (10)

Such data, however, are usually not available. A cruder (but more feasible) alternative is to ask the lender to estimate the typical (most common) frequency. The typical frequency, however, may differ from the average frequency. For example, if 30% of loans have weekly installments and 70% have monthly installments, then the typical frequency is monthly, but the average frequency is \(0.3\frac{7}{7} + 0.7\frac{365}{12}\_23\) days.
The typical frequency is appropriate when most loans have the same frequency, while the average frequency is appropriate when no one frequency dominates.

**Example**
For the example Latin American microlenders, the typical installment frequency (Table 1, line q) was 14 days for lender A, 28 days (4 weeks) for lender B, and 30.5 days (one month) for lender C. Like other measures of loan size already discussed, the typical frequency suggests that A makes smaller loans than B or C. Unlike most other measures, the typical frequency also suggests that loans from B and C are about the same size.

The average installment frequency (line r), computed from a sample of loans, was 13 days for lender A, 19 days for lender
Seven Aspects of Loan Size

B, and 23 days for lender C. Again A is smaller than B or C, and now B, as by most other measures, is a bit smaller than C.

**Number of Installments**

All else constant, loan size increases with the number of installments. This is pictured as the number of steps in Figure 1. This aspect does not consider time.

For borrowers, more installments mean more transaction costs to make payments. More installments also mean more chances to fall into arrears, and this increases the psychological costs of being in arrears and of dealing with enforcement visits from the lender. Thus, poorer borrowers generally have fewer installments.

For lenders, more installments increase costs (and decrease profits) because tellers and administrators spend more time on cash transactions. More installments also increase lender costs because loans have more chances to fall into arrears and to require enforcement visits. All else constant, more installments decreases profit.

More installments implies larger loans, less profit, and less depth of outreach.

**Formula**

The best way to measure the average number of installments is with data on all loans outstanding at a point in time or on all loans disbursed in a year. This data is usually unavailable. A second-best proxy for the average number of installments is:

\[
\text{Number of installments} = \frac{\text{Average term to maturity}}{\text{Average frequency of installments}}. \tag{11}
\]

**Example**

Lender A had the most installments per loan (9.6, Table 1, line 4). Lender B came next (8.6), and lender C had the fewest (8.2). Unlike all measures of loan size discussed so far, the number of installments suggests that A has the largest loans, B the next
largest, and C the smallest. This shows again how loan size varies by aspect.

**Dollars per Installment**

In Figure 1, the vertical distance between steps is dollars per installment. Higher steps mean larger loan sizes. This measure ignores time.

For borrowers, dollars per installment matters for depth of outreach because, all else constant, poorer borrowers are less likely to be able to pay large installments. For lenders, this aspect matters for lender profitability because larger installments help to dilute the fixed costs of the cash transaction. Thus, larger loans in terms of dollars per installment imply more profits and less depth of outreach.

**Formula**

The ideal way to measure dollars per installment is with data on each installment due in a year, but external analysts rarely can get such data. A crude alternative that uses commonly available data is:

\[
\text{Dollars per installment} = \frac{\text{Average dollars disbursed}}{\text{Average number of installments}}. \quad (12)
\]

Equation 12 ignores the interest portion of installments. This omission matters most for absolute measures of loan size and for loans with large disbursements or long terms to maturity, but it is not a major issue for most comparisons among lenders.

**Example**

Among the example lenders, A had the fewest dollars per installment ($52, Table 1, line t), B was intermediate ($77), and C was the largest ($83). The relationships are close to those for amount disbursed (8% difference between B and C, 60% difference between C and A).
Dollar-Years of Borrowed Resources

The best summary measure of loan size is probably dollar-years of borrowed resources. In Figure 1, this is the shaded area southwest of the cash-flow steps. Dollar-years of borrowed resources accounts for time and incorporates all the other six aspects of loan size: term to maturity, dollars disbursed, average balance, time between installments, number of installments, and dollars per installment. Loan size increases with dollar-years of resources from a loan.

Dollar-years of borrowed resources measures the purchasing power provided by the loan and the time through which the borrower controls this purchasing power. For example, a $100 loan with one balloon installment after one year provides the use of a dollar for a year, or 1 dollar-year. A $100 loan repaid in 12 monthly installments provides 50 dollar-years; the purchasing power provided through time is the same as that of a $50 with one balloon installment after one year. Finally, a $100 loan repaid in 6 monthly installments provides 25 dollar-years; average balance in the 6 months is $50, and the $50 in half a year is equivalent to $25 in a full year.

For lenders, dollar-years per loan indicate the resources that earn revenue and that are at-risk of loss from default. This measure is better than average balance because, unlike average balance, it accounts for the term to maturity. On the whole, more dollar-years per loan imply greater profitability.

For borrowers, dollar-years per loan measures the typical debt burden as well as the amount of resources provided. Again, this is better than average balance because it accounts for the term to maturity. More dollar-years implies less depth of outreach.

Formula

Given data typically available to an external analyst, an estimate of average dollar-years of resources from a loan is:
In contrast to the average balance, which has units of dollars per loan, this measure has units of dollar-years per loan. If a portfolio has grown in the year, then this formula will slightly overestimate the true figure.

Example
More than any other aspect of loan size, dollar-years of borrowed resources highlights the large differences among the three example lenders. While lender A provides 130 dollar-years per loan, lender B provides about 227 dollar-years, and lender C provides 337 dollar-years (Table 1, line u). In short, loans from lender C are 50% larger than loans from B and 160% larger than loans from A.

Better Measurement of Loan Size
This paper has discussed how seven aspects of loan size affect depth of outreach and profitability. The most common summary measures—dollars disbursed and average balance—ignore term to maturity. Dollar-years of borrowed resources is a better measure because it encompasses the other six aspects of loan size and accounts for time.

Furthermore, common ratios that compare average dollars disbursed or average balance to per-capita GNP lack useful interpretations. Better alternatives compare cash inflows from a loan to cash inflows from income or compare dollar-years from a loan to dollar-years from income, if all income were saved.

Depth of Outreach and Profitability
Greater loan size usually means more profitability for the lender but less depth of outreach for the borrower. Of course, improvements in efficiency (or other innovations) can increase
Seven Aspects of Loan Size

both depth of outreach and profitability. Because poorer borrowers cannot demonstrate and guarantee their creditworthiness as well as less-poor borrowers, however, efficient lenders must trade off depth of outreach against profitability. Innovations can remove the trade-off temporarily, but the trade-off will reappear once lenders reach the efficiency frontier (Gonzalez-Vega, 1998; Rhyne, 1998).

Latin American Examples

This paper used publicly available data to measure aspects of loan size for three large microfinance organizations from Latin America. The main insight is that relative loan size varies widely by aspect. Small differences between lenders A and C in amount disbursed ($494 versus $681, or 38%) and in term to maturity (4 months versus 6.2 months, or 55%) exist side-by-side with large differences in the summary measure of “dollar-years of borrowed resources” (130 versus 337, or 160%).

Caveats

Measurements of loan size mean little in a vacuum. Good analyses will look for the why behind the measure of different aspects. For example, lender A might have small loans not because it lends to poor borrowers (and has greater depth of outreach) but because it is excessively conservative. Likewise, if lender A is more efficient than lender C, it might make smaller loans and yet also make larger profits.

Loan size for a lender should be analyzed through time. For example, an analysis of mission drift might look at loan size over a stretch of three or more years.

Other aspects of loans, aspects not discussed in detail here, also matter for both depth of outreach and profitability. Examples include interest rates, fees, guarantee requirements, and whether the loan is disbursed to an individual or through a group.

The fixation on loan size does not imply that bigger is better. What matters for social welfare is not that loans are large
but rather that the aspects of loan size be tailored to the
demand of the borrower, subject to the profitability and tech-

nological constraints of supply by a lender (Rutherford, 2000;
Schreiner, 1999).

Finally, the measures in this paper are necessarily crude
because they use only aggregate portfolio data, the data gener-
ally available to external analysts. A more complete analysis
would use data on individual loans. This would allow, for
example, analysis of medians instead of averages.

Notes

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Seven Aspects of Loan Size


### Table 1: Aspects of loan size for three example Latin American lenders

<table>
<thead>
<tr>
<th>Line</th>
<th>Aspect of loan size</th>
<th>Formula</th>
<th>Microfinance organization</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>1.</td>
<td>Term to maturity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a</td>
<td>Number of loans out., annual ave. (thousands)</td>
<td>Data</td>
<td>12.5</td>
</tr>
<tr>
<td>b</td>
<td>Number of loans disbursed in year (thousands)</td>
<td>Data</td>
<td>37.2</td>
</tr>
<tr>
<td>c</td>
<td>Ave. term to maturity</td>
<td>12*(a/b)</td>
<td>4.0</td>
</tr>
<tr>
<td>d</td>
<td>Dollars out., annual ave. (thousands)</td>
<td>Data</td>
<td>4,835</td>
</tr>
<tr>
<td>e</td>
<td>Dollars disbursed in year (thousands)</td>
<td>Data</td>
<td>18,391</td>
</tr>
<tr>
<td>f</td>
<td>Ave. term to maturity</td>
<td>12*(d/e)</td>
<td>3.2</td>
</tr>
<tr>
<td>2.</td>
<td>Dollars disbursed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>g</td>
<td>Ave. dollars disbursed</td>
<td>e/b</td>
<td>494</td>
</tr>
<tr>
<td>h</td>
<td>Per-capita annual GNP</td>
<td>Data</td>
<td>900</td>
</tr>
<tr>
<td>i</td>
<td>Ave. dollars disbursed/Per-capita annual GNP</td>
<td>g/h</td>
<td>0.55</td>
</tr>
<tr>
<td>j</td>
<td>Loan inflow/income inflow in loan term</td>
<td>(g/h)*(12/c)</td>
<td>1.6</td>
</tr>
<tr>
<td>3.</td>
<td>Average balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>k</td>
<td>Dollars out. at year-end (thousands)</td>
<td>Data</td>
<td>7,089</td>
</tr>
<tr>
<td>l</td>
<td>Number of loans out. at year-end (thousands)</td>
<td>Data</td>
<td>16</td>
</tr>
<tr>
<td>m</td>
<td>Average balance at year-end</td>
<td>k/l</td>
<td>440</td>
</tr>
<tr>
<td>n</td>
<td>Average balance during year</td>
<td>d/a</td>
<td>388</td>
</tr>
<tr>
<td>o</td>
<td>Average balance during year/Per-capita annual GNP</td>
<td>n/h</td>
<td>0.43</td>
</tr>
<tr>
<td>p</td>
<td>$-years from loan/$-years from income</td>
<td>[n*(12/c)]/(h/2)</td>
<td>2.6</td>
</tr>
<tr>
<td>4.</td>
<td>Time between installments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>q</td>
<td>Typical installment frequency (days)</td>
<td>Data</td>
<td>14</td>
</tr>
<tr>
<td>r</td>
<td>Average installment frequency (days)</td>
<td>Data</td>
<td>13</td>
</tr>
<tr>
<td>5.</td>
<td>Number of installments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>s</td>
<td>Average number of installments</td>
<td>c*(365/12)/r</td>
<td>9.6</td>
</tr>
<tr>
<td>6.</td>
<td>Dollars per installment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>t</td>
<td>Average dollars per installment</td>
<td>g/s</td>
<td>52</td>
</tr>
<tr>
<td>7.</td>
<td>Dollar-years of resources from a loan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>u</td>
<td>Average dollar-years of resources from a loan</td>
<td>d/b</td>
<td>130</td>
</tr>
</tbody>
</table>

Note: Monetary figures in units of constant December 1998 dollars. *Data* marks numbers from sources outside of this table.
Seven Aspects of Loan Size

Figure 1: Seven aspects of loan size

Figure 2: Loan size for lenders A and C
Institutional Alternatives for the Promotion of Microfinance

Self-Help Groups in India

by P. Satish

Abstract: Microfinance is now an accepted institutional framework for taking financial services to the poor. It is but natural that microfinance should have had tremendous growth in India—the home to the largest concentration of poor. In India the microfinance technology that had a relatively higher growth in the last decade is the self-help group (SHG). This lays stress on thrift as well as credit and also on the linkage between informal groups and formal financial institutions. An important sine qua non in this technology is the institution that promotes the SHGs. In India, SHGs have been promoted by nongovernmental organizations (NGOs), banks and the government. This paper attempts to compare the role of these three institutional variants in promoting the SHGs, their strengths and weaknesses, and the best practices that could be copied from them.

Introduction

Over the last decade microfinance has become an accepted institutional framework for taking financial services to the poor. Microfinance has now evolved into a type of independent financial system of its own and there are a number of variants in microfinance institutions and systems. But broadly
they can be classified into two—the individual approach and the group approach. An example of the group approach, where the group itself, not the individual member, is the client, is the self-help group program in India.

In India, savings and credit groups known as self-help groups (SHGs) have grown many fold since the National Bank for Agriculture and Rural Development (NABARD) introduced the pilot project in 1992. NABARD is the apex financial institution, established by the Government of India in 1982, for promoting, monitoring, and refinancing the rural financial system in India.

The purpose around which an SHG is initially formed varies depending on the kind of program being implemented and the need for collective working. It varies from managing a collective resource to promoting a social cause. In the context of microfinance, SHGs are formed (and sometimes old SHGs established with another purpose are converted) to foster savings and credit. A small group of individuals become members and pool their savings on a regular basis to form a collective fund. This fund is then rotated as credit amongst the members through a system of self-generated norms. Hence, the basis of the SHG is the mutuality and trust in depositing individual savings in group funds. Once the initial trust is established, the incentive or motivation for a member is the access provided to financial services through the common pool fund, which is higher than the individual’s own savings. Once such an SHG is formed and stabilized (through repeated rotations of their own savings converted to mutual credit), it is possible for it to become a source of funds to others outside the SHG.

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As a part of its mandate, NABARD initiated certain research projects on SHGs as a channel for delivery of microfinance in the late eighties. Amongst these, the project sponsored by the Mysore Resettlement and Development Agency (MYRADA) on “Savings and Credit Management of SHGs” was partially founded by NABARD in 1986–87. In 1988–89, in collaboration with some of the member institutions of the Asia Pacific Rural and Agricultural Credit Association (APRACA), NABARD undertook a survey of 43 nongovernmental organizations (NGOs) in 11 states in India, to study the functioning of microfinance SHGs and their collaboration possibilities with the formal banking system (NABARD, 1991). Both these research projects produced encouraging possibilities, and NABARD initiated the pilot project called the SHG linkage project in 1992. NABARD also held extensive consultations with the central bank—the Reserve Bank of India. This resulted in issuing a policy circular to all commercial banks to participate and extend finance to SHGs (RBI, 1991). NABARD also issued a broad set of flexible guidelines in February 1992 (NABARD, 1992) to the formal rural banking system, explaining the project’s modalities. The project was extended to the regional rural banks and co-operative banks, in addition to the commercial banks in 1993.

The main objectives of this project were: (1) to evolve supplementary credit strategies for meeting the credit needs of the poor by combining the flexibility, sensitivity, and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resources of formal financial institutions; (2) to encourage banking activity, both on the thrift and credit sides, in a segment of the population that the formal institutions usually find difficult to reach; and (3) to improve credit flow to rural poor with reduced transaction costs, both for the financing bank and the borrower.

Policy interest in the whole concept of SHG linkage with banks was institutionalized with the RBI establishing in 1995 a
The working group (RBI, 1996) has commented thus on the progress of SHGs in India:

1. SHGs helped to generate and collect small thrift amounts from a cross section of people hitherto considered incapable of saving. The essential difference between thrift and savings was that while thrift was generated out of deferred consumption, the savings were generated out of surplus.

2. SHGs have facilitated the rural poor in fulfilling their credit requirements, both for emergent consumption needs as well as for small production requirements.

3. SHGs have been able to meet successfully the credit requirements of the rural poor as per their choice, unlike in the case of borrowing under other programs of formal credit institutions.

4. The high recovery rates of the SHGs are in sharp contrast to the poor recovery performance of banks in respect of various activities under rural credit. Since credit/finance was seen as management of the participants’ own funds and enterprises, a feeling of ownership and responsibility was generated.

5. The entire cycle of assessing need, disbursement, recovery, monitoring, and supervision shifted closer to the scene of action under SHGs, and therefore the transaction cost of the loans was relatively less.

In developing microfinance in India, especially through the SHGs, a major role is that of the promotional institutions. Several institutional variants of the Self-Help Promotion
Institutions (SHPIs) have come to the fore since the beginning of the last decade. In India, the promotional institutions are basically of three types: (1) governments (2) banks and (3) NGOs. These institutions have over a period of time developed systems and practices, some of which can be emulated as best practices and some others which should be learning points for caution. This paper looks at one case study of each of these institutions and their practices in microfinance in India to see what can be learned from their experiences.

In India the government is a ubiquitous institution. Therefore, the first institution which this paper studies is that of government as an SHPI.

**Government**

In most developing countries, the policies concerning rural credit were, by and large, based on certain assumptions, some of which were:

- The commercial banks were reluctant to provide for the credit needs of the rural poor for reasons that were neither commercial nor economic.
- The rural poor did not have any capacity to save.
- Rural people needed credit on a concessional rate of interest and relaxed terms for taking up income generating activities, especially development works on their farms.
- Informal finance did not play a positive development role and it was an evil that should be eliminated.

The policy framework that grew out of these assumptions did not contribute to the self-sustained growth of the rural credit system and it also did not adequately serve the rural poor.

As in all developing countries, in India development was considered to be the government’s responsibility and it started several subsidy-linked credit programs where it had a major role right from the stage of identifying of the borrowers to the disbursement of credit and subsidy. The results of these programs were not positive. Experience has shown that the non-
involvement of the people has led to an attitude of total dependence on administrative efforts. This was especially true in credit programs for the rural poor. To overcome this, government started adopting participatory approaches to rural development, particularly the SHG approach.

The entry of the government into the self-help group movement was through the Rashtriya Mahila Kosh, which started funding NGOs for forming and nurturing SHGs. Later, the Indira Mahila Yojana came into existence, which also facilitated the group formation and nurturing process.

The following is a case study in which the government acts as a SHPI, though in a passive and an indirect manner.

Podupulakshmi

Nellore is the southernmost coastal district of Andhra Pradesh, a state in the southeast of India. During 1991–92, the women of the district participated very enthusiastically and voluntarily in the total literacy program. Later, the women of Nellore district were in the forefront of the “Anti-Arrack” movement. As a consequence of this movement, the government imposed a ban on the sale of country liquor in April 1993. The implementation of this ban led to a peaceful and better life for the rural people in Andhra Pradesh State. This also generated some surplus funds at the village level. At this juncture, the women of Leguntapadu Mandal of Nellore district decided to put their surplus funds together in the form of joint savings. That led to the informal formation of the groups at the initial level. Later, following the example of the women of this Mandal, women in other parts of the district understood the benefits and started forming themselves into thrift and credit groups. The formation of groups by the rural women of the district came to the notice of the District Rural Development Agency (DRDA) and the district administration. The district administration then decided to involve itself fully in the formation of the thrift and credit groups. The administration pressed into service the local teachers, village administrative officers (VAOs), and village development officers (VDOs). A cell for thrift and credit
groups was also created at the DRDA. The scheme became popular in the entire district and with the active involvement of the district administration it spread to all the 46 Mandals of the district. At the end of July 1996, the total number of groups in the district was 6,907 with a membership of 202,000. Approximately 95% of the rural families had at least one member among the Thrift and Credit groups. The total savings mobilized was Rs. 9.63 millions.

**Organization of Groups**
The members of the groups were women from low-income families in the rural areas, and the membership of most of the groups varied from 30 to 50. Each group selected one member as their group leader. The group leaders had adequate knowledge to maintain the simple accounts and also were acceptable to the group. Each group had one guardian who was normally a government employee working at the village level, such as a teacher, a VAO, a VDO, a representative of a voluntary organization, or a social worker. These guardians have played a very important role in motivating the women, in initiating the group action, and later in guiding the groups.

**Operation of Savings and Credit**
Typically in every group, the members were expected to save Rs. 1 per day for an initial period of 3 years. The group leaders collected the amounts from the members once a week or fortnight at their convenience and ensured that the amount of Rs. 30 for each member was deposited by the end of the month in the bank account or the post office. Each member was given a pass book recording the particulars of monthly savings. After one year of savings, the groups started making loans out of the accumulated savings. The group also maintained a register (ledger). All the entries of thrift and credit were required to be recorded in this register.
The Working of the Groups

Each group was expected to meet once a month during the first year and discuss the question of thrift and credit. They also discussed developmental and welfare activities in the village. The important issues discussed during the meetings were recorded in the minutes book with the help of the guardians. The writing of the books was initially done by the guardians. However, gradually the literate members of the groups were required to take over the task of writing the books.

Training

Since not all of the women involved in the program had necessary financial skills, training programs were begun for all the people involved. Group leaders and an additional member of each group were trained in one-day workshops conducted at the Mandal levels with financial assistance from UNICEF. The training was also extended to the teachers, VAOs, VDOs, volunteers, and social workers who were guardians of these groups. The group leaders were also trained in the maintenance of accounts and handling the transactions with banks and the post office. Officers at the Mandal and Panchayat level were also sensitized in a series of training programs.

Organizational Support for the Program

After the district administration took an interest in the implementation of these programs, a district-level committee was constituted for program implementation, with the District Collector as the chairman, DRDA Project Director as the convener, and other important district officers as the members. At each Mandal level also a committee was formed and at the village level a committee under the chairmanship of the Sarpanch of Panchayat was formed for the effective implementation of this program. However, the actual work of implementing the program is being looked after by a special cell called a Podupulakshmi cell at DRDA.
Linkage with Banks
A feature noticed in the entire program was that though a number of groups were formed in the district and a large number of them opened their accounts with the banks, the linkage between these groups and the banks was at a very minimal level and in the year 1994–95 only two groups were financed by the banks. At a later stage of development of these groups, it was realized that the savings of these groups would not be sufficient to meet the credit requirements of the group members. Therefore, they would have to be supplemented by outside financial assistance in the form of bank credit.

Positive Features Observed
The positive features observed in the thrift movement in Nellore district were:

• The women were ahead of NGOs, government, and banks in taking initiative for forming of the thrift and credit groups. It was only later that government and voluntary workers involved themselves in the program.

• The groups showed interest in various welfare and developmental programs in the district and the women started associating themselves with the problems of the village.

• The groups were able to represent their problems at the village level to administration at various levels and to try and solve their problems.

• The status of individual women members in the family has improved tremendously with self-confidence and financial independence.

• The women groups have actively participated in the implementation of the prohibition policy of the state government.

• There was also an awakening in the Nellore district with regard to health and sanitation. The women groups have come forward in controlling gastroenteritis, popularizing healthy living practices, and creating sanitation facilities.
The massiveness of the program implemented in the Nellore district was nowhere to be matched. The formation of about 7,000 groups with a total of about 202 thousand members and a savings of nearly Rs. 9.7 millions in a single district was an incomparable and massive achievement in which the district administration has played a very big role.

Some of the drawbacks and negative features observed in the program were:

- The involvement of the district administration has tended to make this just another government program, and many times the lower level government functionaries were keen only on achieving the targets set. This has led even to non-stabilization of a number of groups. The percentage of nonstable groups was quite high at 31%.
- The involvement of lower level government functionaries as guardians and joint account holders has also created a vested interest; there were many instances of these officials not being ready to give up the guardianship.
- In many groups, sufficient importance was not given to regularity in meetings, need for group action, regularity in savings, and proper maintenance of records.

Conclusions

Despite these drawbacks, this program does not have a parallel anywhere else in the country, and its success proves that in the formation and nurturing of SHGs the district administration like DRDA can also play a role. But in this particular district, the administration played its role only after the people started organizing themselves into groups and saving their surplus money. Then the government machinery intervened and converted it into a program for development. It is, therefore, doubtful if the program can be replicated by other government agencies in other parts of the country.
Among the formal institutions, next to government, banks play a major role as self-help promotion institutions in India. For several years, since the nationalization of the commercial banks, there has been a commitment at the highest policy levels, towards improving access to financial services for the poor. Several policy measures have also been in force to ensure this, such as the allocation of committed bank funds to small loans (priority sector banking), subsidized interest rates (ranging from 4% to 10%) for micro loans, and the opening of small rural bank branches. Hence, the mainstream banking system in India has always been involved in microfinance as a special area of their operation.

At the operational level, this policy commitment has been implemented usually by linking bank credit to a targeted program of the government of India. The Integrated Rural Development Program (IRDP) was a typical example. Based on this program, several projects of the government of India have had a strong microfinance component either through the banks or through government-established financial institutions. A further institutional focus was given to rural lending through small loans by establishing the regional rural banks in 1975.

The SHG linkage program is located in this national policy and institutional context, where there is a vast network of primary lending institutions to deliver microfinance on the one hand, and an apex national level institution, namely NABARD, to provide policy support and refinance on the other.

Banks have been slow in entering the field of microfinance from the angles of both promoter as well as lender. In general, banking institutions have treated the formation and promotion of SHGs as an activity which is strictly for voluntary agencies or nongovernmental organizations and not for mainstream commercial bankers. But the problem in India is that well-intentioned NGOs which can take up these activities are confined to relatively smaller pockets of the country. If banks see
a new opportunity and a new market in microfinance they cannot always expect a ready-made institution to absorb their lending portfolio. It may be necessary for some banks to take up the work of forming and promoting SHGs on their own if they view it as a profitable market and a profitable business opportunity. Several banks, especially regional rural banks (RRBs), have done pioneering work in forming, promoting, and later financing SHGs.

In this method, the role of mobilizing and forming the SHG is taken up by the bank branch itself. There is no NGO facilitation. Although this model is not common, many banks have shown interest in forming SHGs themselves. However, this alternative is fairly unique, as banks do not usually go into social mobilization roles. Irrespective of the quality of the SHGs formed, the weaknesses of this alternative are obvious. The core competency of a banker is finance and not SHG formation. Even if the SHG formed is for the limited purpose of fund rotation, substantial effort has to be made to form SHGs. Further, SHGs formed only for receiving external funds may not be sustainable. The advantage of this alternative, however, is that it exposes the banker to social realities firsthand. Also, in all the places where NGOs are not operating, some mechanism needs to be found to improve access to microfinance. Strategically, this option may not have the possibility of widespread adoption. The experience of a bank as a self-help promotion institution is discussed in the following case study.

Cauvery Grameena Bank
The Cauvery Grameena Bank (CGB) is a regional rural bank established in 1976 with headquarters at Mysore in the southwest Indian state of Karnataka. The CGB has 115 branches and covers the districts of Mysore and Hassan. The CGB has a wide network of branches, covering 913 out of the total 1837 villages in the Mysore district. The bank has been actively involved in financing the rural poor since its inception, in conformity with the mandate of the regional rural ranks. In this process, the bank has experimented with innovative rural
credit deliveries. One such experiment is financing the rural poor through self-help groups.

**Financing of SHGs**
MYRADA has a vibrant presence in Mysore district. It has formed SHGs in the district and also trained bank officials on SHG-related activities. Taking advantage of the presence of several groups in their area, the CGB started linking them to bank finance in 1992. By March 1996, the bank had financed 222 SHGs covering 4669 members (averaging 22 members per group). The groups had mobilized savings of Rs. 30.74 millions by October 1996 and made loans of Rs. 3.62 millions. The experience of financing SHGs was very good, with the bank recovering 96.6% to 98.7% of loans between 1993 and 1996.

**Formation of SHGs**
In 1995, emboldened with the success of financing SHGs, the CGB decided to expand its role to the formation of groups. In its new efforts of social engineering, the bank selected Gundlupet Taluk\(^5\) for their experiment of group formation and nurturing. Gundlupet was selected because of its remoteness (bordering Tamil Nadu state) and the predominance of resource-poor farmers and agricultural laborers. Moreover, Gundlupet was not served by any NGO, including MYRADA.

Gundlupet Taluk was served by five branches of CGB. All the five branches were actively involved in group formation. The pioneering efforts of CGB were unique in the sense that all the employees of the branches, including the messengers were involved in the formation of groups. All the employees of the branches were trained by MYRADA in the formation, nurturing, and financing of SHGs. The well-conceived, tailor-made training programs of MYRADA for CGB employees were attended by the branch manager and field officers, along with their messengers.
Group Formation
The branch deliberated elaborately before deciding the village to be selected for group formation. The branch manager, field officer, clerk, and messenger participated in the deliberations. Because they were local people who belonged to the area and mostly lived in the villages served by the branch service area, the messenger and clerk were generally able to give sound advice to the branch manager about village selection. The backwardness of the village was the main criterion for selection. After the village was selected, the manager and the field officer visited the village together a couple of times for an overall survey, and for each such visit they spent about half a day of work. These two officials followed it up with about five more visits of a half day each, during which they identified the members and mobilized them for group formation.

Message of Self-Reliance
CGB officials were very meticulous about group formation. They ensured right in the beginning that the group members did not have any false hope about receiving a government subsidy or bank loan. Internal strengths and self-reliance were given considerable stress. With several anecdotes and examples, the message of “Strength in Unity” was conveyed to the potential members. Members were generally convinced that self-respect lies in helping themselves rather than in relying on external help.

The CGB made it mandatory that all the groups should meet once a week, because meetings at weekly intervals help to develop cohesion among the members. Moreover, it was easier to mobilize small amounts of savings frequently than to mobilize large amounts at longer intervals. The bank also made it mandatory that the weekly meetings be attended by the branch staff without fail, particularly in the initial three months of nurturing. However, such meetings could be attended by any one of the branch staff, including the messenger.
Group Linkage

A minimum of 80% attendance was insisted on for all the groups during the initial 3 to 6 month period to become eligible for bank linkage. No groups were linked till they were six months old. Thus, even though 51 groups were formed by the branch staff up to October 1996, only 8 were linked. The remaining groups were awaiting the completion of the mandatory six-month period.

Immediately after groups were formed, the members were trained on the concept and characteristics of SHGs, the role and responsibilities of members, and accounts maintenance. Training intervention was had by the CGB staff themselves. They have successfully employed the members of a couple of existing groups for training new group members through street plays and skits.

CGB’s project has demonstrated that banks can also play a positive role as promoters of SHGs. The positive features observed in the project were:

- Because all the members of the branch staff were trained by MYRADA in the formation, functioning, and financing of SHGs, the groups were stable and functioning well.
- Because the entire branch staff was trained and motivated, even if the manager was transferred from the branch, there was continuity in the staff’s involvement in the SHGs.
- The groups formed by CGB staff met and saved every week. This fostered and created better cohesion among the members.
- The branch staff believed that their intense interaction in the initial stage of formation and functioning enable the groups to become independent early.
- The branch managers were confident that even groups of illiterate members could become independent by employing the services of an educated person in the village for the maintenance of books.
Managers also believed that in the future, group formation would be easier because of the demonstrative effect of the successful group.

Some drawbacks and negative features observed were:
- The weekly meetings resulted in frequent operation of the SHG account at the branch (every SHG opens a saving account soon after it is formed) due to the weekly credit and withdrawals, which added to the bank’s work as well as costs.
- The branch’s cost for nurturing groups was also very high because during the initial period, the branch staff attended all the weekly meetings of the group. On average, the cost of nurturing a group worked out to Rs. 10,088 per year.
- The bank has not yet worked out a comprehensive cost-benefit analysis of this program.

**Conclusion**

The experience of Cauvery Grameena Bank reveals that banks entering the arena of promoting SHGs have to be systematic. This bank concentrated on a single block, where it had five branches. The branch staff was trained intensively by MYRADA. The process that this bank adopted in group formation and nurturing was also systematic and they tried to ensure that it was a gradual process. The experience shows that banks, especially RRBs, can play the role of self-help group promotion Institution at least in a few of their branches.

**Nongovernmental Organizations (NGOs)**

Though government and banks have been played positive roles in the promotion of SHGs, in terms of numbers, the nongovernmental organizations (NGOs) rank as the premier SHPIs. NGOs have so far been the main innovators in microfinance. They have many advantages. Their very name, *nongovernmental*, indicates that they are outside the framework of government. In India, where governmental systems are fairly
rigid and bureaucratic, NGOs are characterized by their flexibility and ability to evolve simplified work systems.

While a group approach has been a developmental concept actively pursued by development practitioners for many years, the focused formation of SHGs under the microfinance framework is a relatively newer concept. It was initiated only in the late eighties by a few NGOs as an exclusive idea. The number of NGOs involved in the formation of microfinance based SHGs has increased many fold in the nineties. Contributing factors in this expansion has been the creation of an enabling environment for this kind of work by several national and international organizations, including multilateral, bilateral, and international NGO donors, plus an encouraging policy environment created by the government of India and the Reserve Bank of India. The SHG linkage program of NABARD through its widening network of institutions has also contributed to expanding the microfinance-based SHG movement.

Because of the expansion of the microfinance-related SHG program agenda, a wide diversity is observed in the approaches adopted by different agencies. Some NGOs act as banking intermediaries, channeling finance to different SHGs formed and centralizing all the accounts and financial systems at the NGO level. Others have formed collectives of several SHGs together, forming a federation of SHGs, and were linked them up with banks. There is also a fair amount of diversity in the levels of competencies and capacities to manage a microfinance SHG program within these agencies.

Donors and national governments now regard NGOs as the most appropriate institutions through which to deliver development services. The majority of donor-funded microfinance projects are implemented by NGOs. Financial support to NGOs has given a fillip to the entire SHG movement. Several hundred NGOs, big and small, are now forming SHGs based on microfinance, and many of these are being linked to local banks for credit.
The nongovernmental organizations who are a part of the SHG-bank linkage programs throughout the country have developed and fostered different types of institutional mechanisms for these groups. While most NGOs have opted for a conventional SHG of 15 to 20 members, some others have opted for different forms, notably the Mahila Mandal or federal type where the group is a single entity at the village level, as a sort of village level federation. While basically all NGOs in the SHG movement have the economic empowerment of the poor, especially women, as their goal, their approaches and their working methods differ. The case study discusses one typical NGO involved in SHG promotion.

Navajyothi

Navajyothi (“new light”) is an NGO working in 28 villages of the Medak district and 10 villages of an adjacent district in the state of Andhra Pradesh. The activities of the organization cover a variety of areas, including adult literacy, tree planting, child care, rural health care, environmental issues, village and community development, organizing women into groups for thrift and credit, rural drinking water facility, care of the aged, literacy for child labor, horticulture, etc.

Organization of Women Thrift and Credit Groups

In working with the rural people in its area of activity, Navajyothi realized that the key to the success of any program of development and change in these areas was the empowerment of women and that it was possible only through women working in union among themselves. Keeping this aim in view, Navajyothi started organizing women’s groups from the year 1992 onwards. The main basis for organizing these women’s groups was thrift and credit since it has been realized that any strong organization has to rest on a certain degree of economic or financial activity and that based on this foundation, the groups can graduate and develop into other areas of concern for socio-economic development.
Institutional Alternatives

The organization of the groups in the villages started first with visits to the villages by the group organizers and coordinators. Initially it was quite difficult for the group organizers to convince women to come out of their houses and form themselves into groups. But in most of the villages, the group organizers as well as the coordinators persisted. For the first 6 months they had to visit each village at least five times a month. Slowly, women started forming themselves into groups with the guidance of the group organizers and coordinators.

In each village, women were organized into groups of ten members each, and all these groups were combined into a Mahila Mandal at the village level. Each group had two group leaders and the Mahila Mandal had a president, secretary, joint secretary and a treasurer. Though technically each ten member SHG is a separate entity, for all practical purposes the focal point was the Mahila Mandal. The meetings were also held for all the groups together. The Mahila Mandals of all the villages were in turn federated into a federation (Samakhya) for which the president, secretary and treasurer of each Mahila Mandal constituted the membership.

**Books and Accounts**

Each group maintained the following registers:
1. An attendance register where the presence, absence, or leave of absence of the members was recorded.
2. A thrift register where the regular savings as well as the contributions to the development fund were recorded.
3. A loan register where the purpose of the loan, the amount of loan, and contributions to development fund, repayment, and the balance were all recorded.
4. A membership register where the member’s name, introducer’s name, and the membership fee were recorded.

The registers were for the Mahila Mandal as a whole, but there were separate folios for each SHG of 10 members. The members were also given individual passbooks for their savings and credit.
Maintenance and Operation of Books and Accounts
As a majority of the members were illiterate, and a few were semiliterate, the writing of accounts was done by the members only in a few cases. In most of the Mahila Mandals, the accounts and the minutes were written by a writer who was paid an honorarium of Rs. 50 to Rs. 100 per month, depending on the size and the economic strength of the Mahila Mandal.

Training
The important training events that Navajyothi organized were a 5-day leadership training program for group leaders at their training center and a 2-day training program on account writing for the account writers of the Mandals (also at their training center). It organized training programs for group members on the formation and the functioning of the groups for a period of 3 days each in the village itself.

Personnel Support by the NGO
The organization had two coordinators and eight group organizers who were working with the Mahila Mandals. These organizers visited the groups regularly on a tapering basis. In the initial period of 6 months the visits were as frequent as 5 times a month, these were reduced to twice a month in the next 6 months. In the second year the visits were made only once a month and from the third year onwards the frequency was reduced to once in a quarter and also according to the need and the occasion. In the first six months, the group organizers also assisted in writing the books, taking minutes, establishing contact with the bank, and so on, but this work was gradually assigned to the group itself.

Credit Operations
In most of the Mahila Mandals, credit operations started after the first three months and these went on with regularity. All amounts given in internal loaning had a repayment period of only one month and the rate of interest charged to members was 30%. In exceptional cases, where a member was not able to
adhere to the one-month repayment period, she was given an extension by converting that amount into a fresh loan. For the groups which started with lower savings per month, the NGO provided seed money of Rs. 5,000 per Mahila Mandal. After this amount was rotated and used by the group it would be returned to the NGO for further assistance to the fledgling groups. The bank loans were obtained from Manjira Grameena Bank, Dubbak branch, for 43 groups under 6 Mahila Mandals.

**Strategy for Withdrawal**

Navajyothi was clear in its view that it would withdraw from groups which complete 5 years of existence. From the first year of stabilization itself, the NGO strategically reduced the number of visits by the coordinators and organizers to the groups. The advisory and guiding role for SHGs will have to be taken by the Samakhya and the NGO’s role in this aspect will cease completely.

The positive features observed in the SHG program of this NGO are:

- A high degree of unity among the members to take up common causes and issues has been noticed.
- This process of group formation has developed qualities of leadership among poor illiterate women in the backward villages.
- Thrift collection of the groups was very regular.
- For internal loaning as well as loans made by the bank branch, the recovery percentage was excellent—100%.
- Loan decisions were arrived at democratically in group meetings. The members and group leaders were able to balance conflicting interests and demands.
- The leadership of the Mahila Mandals and groups was truly democratic and there was a regular rotation of leadership.
- The groups displayed a confidence in their ability to manage their own affairs.
- There was no dependency syndrome in the groups as far as dependence on the NGOs was concerned.
In the operating villages the coverage of the Mahila Mandal was wide. They covered nearly 60% of the families in each of these villages.

In each group there were regular internal loaning and repayment. Transactions in internal loaning ranged between Rs. 5,000 and Rs. 7,000 per month per Mahila Mandal.

Some negative features observed were:

- The groups were not sure of the income-generating activities that they could take up.
- The NGO seemed to be spreading its personnel thinly on a wide range of activities that may not facilitate concerted efforts in the SHG program.

Conclusion

Navajyothi’s experience indicates how a nongovernmental organization can be a successful SHG promotional institution, if it is able to take care of certain basic requirements.

Best Practices

The three institutional variants of self-help promotion institutions and their case studies enable us to summarize the learnings for the benefit of future growth of microfinance SHGs in India. The case studies reveal that the NGOs, the banks and the government have been equally successful as self-help promotion institutions since the SHGs formed, nurtured, and promoted by them have met the requirement of taking financial services to the poor and have contributed to the economic empowerment of the underprivileged, especially women. The successes therefore were not due to the nature of the institutions alone, but to the best practices these institutions evolved, nurtured, and followed.

Based on the experiences of the working of NGOs and other SHPIs covered in these case studies, the following could be the best practices which the SHPIs would have to follow so
that each component of the SHG promotion work is carried out to a high degree of success.

**Identification of the Villages**
Identification of a particular village by an SHPI should be based on certain norms, keeping in view the overall aims and objectives of the SHPI in that region. A pre-identification survey should be done wherein all the statistical and other data is collected by the SHPI. It is also necessary that the SHPI conduct a participatory rural appraisal (PRA) in the village to build up a rapport with the villagers and identify their problems.

**Identification of the Members**
After the identification of the village, the SHPI must carefully identify the first lot of the members of the first group in the village. Since the positive or negative outcome of the first group may determine the fate of the future activity of the SHPI in the village, it must choose the first members carefully.

**Group Formation**
After the members are identified, they must be taught in detail all the basic rules which govern the functioning of the groups, especially group discipline, regularity in attendance, and regularity in savings and loans. The formation of the group is a natural evolutionary process and as such the SHPI should give a reasonable time for the group to slowly evolve.

**Mobilization and Stabilization of the Group**
This is a process of evolution for the group and would take about 4–6 months involving about 6–8 visits by the SHPI. During this phase, the following items are also to be taken care of by the SHPI:
- Bylaws and rules: The group will need guidance regarding formalities like bylaws and rules. A set of bylaws and rules should be evolved by the group, if necessary, with the assistance of the NGO or other SHPIs.
Records and books: Every group must have a certain set of records. These records should give a full and transparent picture of the group activities. But a group of illiterate or semiliterate rural poor should not be bothered with too many records and books to maintain. The writing of books should also be the responsibility of the group members. The SHPI personnel may help in the initial stages, but their assistance for accounts writing should not continue forever. If no literate members are available in the group, they should be encouraged to employ some local writers on a payment of honorarium.

Training: A very important aspect of the nurturing and strengthening of the SHGs is appropriate training, which must be extended to them at different points of time. At the grassroots level, all members should be exposed to training on the formation and functioning of the groups where the necessity for group formation and the importance of group dynamics are discussed with the members in a simple understandable form in the local dialect, and the leaders—the president, the secretary, etc.—should be exposed to leadership training programs.

Meetings: Meetings are the core of the activity of any SHG. In fact, the evolution of the groups is through these meetings. Thus, the regularity of the meetings has to be built in into the functioning of the groups. For this, it is necessary that the representatives of the SHPI are present during all the meetings in the first year of the group’s existence to guide the group in its process of evolution.

Dealings with banks and other institutions: In the initial period, the groups require some support from the SHPI with regard to their dealings with the bank branch and other outside financial and nonfinancial institutions. This help also should gradually be reduced and the group leaders and members should be able to take care of their dealings with the banks after a certain period of time.
Conclusion

These case studies reveal that a larger numbers of groups are formed by NGOs, but they are not the only SHPIs. Banks, especially regional rural banks, have also formed SHGs. Qualitatively these groups are equally good when compared to the groups formed by NGOs. But due to the constraints of their staff and the regular banking business, banks may be able to promote only a limited number of groups. Apart from the NGOs and the banks, the government is a notable institution that has been promoting SHGs. The case study reveals that the success of the government in SHG promotion is restricted to the districts where the development administrations work in a true spirit of an SHPI following the best practices.

We may therefore conclude by commenting that in the final analysis, from the view of institutional framework, an institution can be considered suitable as a self-help promotion institution if it is in a position to foster and nurture the best practices for SHG promotion.

Notes

1. MYRADA (Mysore Resettlement and Development Agency) is an NGO based in the South Indian city of Bangalore. It has done the pioneering work with regard to Thrift and Credit Groups in India.

2. APRACA (Asia Pacific Regional Agricultural Credit Association) is an association of banks and financial institutions involved in agricultural credit promoted by the Food and Agricultural Organization of the UN.

3. Regional rural banks are small-sized banks extending to one or two districts. The central and state governments and a commercial bank that sponsors them jointly own these banks. These banks started working in 1975. Today there are 196 such banks in India with a branch network of 14,000.

4. The Rashtriya Mahila Kosh is a government-created fund, which extends financial support to NGOs for forming, nurturing, and financing self-help groups.

5. The Indira Mahila Yojna is a government scheme for women’s empowerment that works through the medium of self-help groups.

6. Arrack is a strong, locally brewed liquor in the southern parts of India.

7. A Mandal is the lowest administrative unit in Andhra Pradesh State, usually covering 30-40 villages.
8. DRDA (District Rural Development Agency) is the agency of the state government that oversees all development activities in a district.
9. The VAO (Village Administrative Officer) is the official in the village who deals with land, revenue, and other administrative matters.
10. The VDO (Village Development Officer) is the official at the village level who looks after the development programs in the village.
11. The Rupee (Re, Rs) is Indian currency unit. The exchange rate during the study period was US $1 = Rs. 36.45.
12. A Panchayat is a village council or assembly.
13. The District Collector is the head of the administration in the district. The term is a leftover from the British Colonial period when this officer used to collect land revenue.
14. The Sarpanch is the elected head of the village self-government unit (the council).
15. A Taluk (a) is an administrative unit (or subdistrict).
16. A Mahila Mandal is a women’s council; it is usually a federation of smaller women’s groups.

References
Microfinance Impact Assessments: The Perils of Using New Members as a Control Group

by Dean S. Karlan

Abstract: Microfinance institutions aim to reduce poverty. Some assess their impact through a cross-sectional impact methodology which compares veteran to new participants and then calls any difference between these two groups the “impact” of the program. Such studies have risen recently in popularity because they are cheap, easy to implement, and often encouraged by donors. USAID, through its AIMS project, encourages this methodology with its SEEP/AIMS practitioner-oriented tools. This paper intends to inform practitioners about the perils of using such a strategy, and suggests a couple of solutions to some of the larger problems with this approach.

Introduction

Microfinance institutions aim to reduce poverty. Some assess their impact through a cross-sectional impact methodology which compares veteran to new participants and then calls any difference between these two groups the “impact” of the program. Such studies have risen recently in popularity because they are cheap, easy to implement, and often encouraged by donors. USAID, through its AIMS project, encourages this methodology with its SEEP/AIMS practitioner-oriented tools. This paper intends to inform practitioners about the perils of
using such a strategy, and suggests a couple of solutions to some of the larger problems with this approach.

This cross-sectional approach makes many assumptions that are untested and others that are tested and false. For example, it assumes that dropouts have, on average, identical income and consumption levels to those who remain. Furthermore, this approach assumes that dropouts are not made worse off by participating in the program. This approach also assumes that when lending groups form they do not sort themselves by economic background. These assumptions not only are brave theoretically but are contradicted by existing empirical research. This paper suggests a method to address the above issues, and suggests further research be conducted on the other implicit assumptions before expending resources on a plausibly unreliable assessment methodology.

This paper proceeds as follows: the next section describes the cross-sectional methodology as implemented by USAID and the SEEP/AIMS practitioner-oriented methodology; the following three sections discuss problems created by drop out, by the selection process, by the dynamic nature of credit policy. Then potential solutions to some, but not all, of the problems are discussed.

Cross-Sectional Impact Assessments
A valid control group is the holy grail of any microfinance impact assessment and must have participants who possess the same “entrepreneurial spirit” as those in the treatment group that receive the loans. The cross-sectional approach claims to fulfill this requirement since both its control and treatment group consist of individuals who have opted to participate in the microfinance institution (MFI). The new entrants are the control group, whereas the veteran participants with two or
more years experience with the MFI are the treatment group. The methodology then attributes any difference between these groups to the MFI, since the new entrants have received little or no treatment from the MFI, but the veterans have received two or more years of loans.

The AIMS practitioner-oriented tools developed by USAID explain this process in detail (SEEP Network, 1999). In this approach, survey takers measure current income and consumption of members, both old and new, in an MFI. Then the analysis compares the income and consumption levels between old and new members. If the mean spending on food, for example, is higher for veteran members than new entrants, then the methodology concludes that participation in the microfinance program led to higher food consumption for its participants.

Advocates like this approach because of two operational advantages: no need to identify and survey nonparticipants in order to generate a control group and no need to follow clients over time as in a longitudinal study.

Dropout

Dropout causes two major problems. The first is an incomplete sample bias and the second is an attrition bias. The incomplete sample bias is created because those who drop out presumably were impacted differently, and potentially worse, than those who remained. Since an impact assessment should examine the impact of the program in its entirety, not just of its success cases, these individuals must be considered as well. The attrition bias is created because those who drop out are different from those who remain, irrespective of the program impact (e.g., wealthier participants stay and poorer participants drop out). Both are serious problems and somewhat easy to address, but the standard AIMS practitioner tools do not resolve them.

Incomplete Sample Bias

For simplicity, think of two types of participants, those who benefit from participation and those who are made worse off.
Those who benefit invest the loan proceeds in their business and generate more additional income than the interest they pay on their loan. These people stay in the program. Those who are made worse off fail to invest the money well and then drop out of the program. By including only those who remain in the program in the treatment group, those who suffer a negative impact are ignored. The cross-sectional impact analysis would find a positive impact, whereas the true impact depends entirely on the relative size of these two groups and how much they are benefited or are made worse off.

The above scenario assumes that drop out is generated by failure. Now assume that dropout is generated by success. After successfully improving their business, learning to manage their money, and developing their own savings base, clients no longer need the credit and hence leave the program. In this scenario, the cross-sectional impact analysis would underestimate impact since the greatest successes are ignored in the analysis.

**Attrition Bias**

Again for simplicity, think of two types of participants, rich and poor. Suppose for the moment that the program has no impact whatsoever, neither positive nor negative, on any participant. Who drops out? If the rich drop out, the “veteran” pool will consist only of the poor types. Then, a comparison of veterans to new participants will conclude a negative impact, since the veterans are only poor but the new participants are a mix of rich and poor. On the other hand, if the poor are more likely to drop out, the “veteran” pool will consist only of the rich. Then, a comparison of veterans to new participants will conclude a positive impact, since the veterans are only rich but the new participants are a mix of rich and poor. Note in both of these stylized cases, there was no impact whatsoever; hence, drop out is not “failure” in this case, merely bad fit. Yet the cross-sectional methodology produced a positive impact (if the poorer individuals are more likely to
Selection

A selection bias refers to the problem of attributing causation to a program with voluntary selection. Those who participate in microfinance programs are more entrepreneurial in spirit, more resourceful in business, and hence more likely to overcome life’s problems one way or another. Attributing their success to microfinance then becomes difficult. The cross-sectional impact assessment purports to overcome this problem, since those in both the treatment and control groups self-selected into the program. This claim only examines the selection bias statically and fails to realize the full dynamics of the decision to participate. Why did those in the treatment group join two years ago whereas those in the control group just joined? The answer is important. Do participants join only at certain points in life? Or if peer selection determines participation, why was one person chosen two years ago and the other not until recently?

Timing of Decision Problem

Why does someone join a credit program now rather than two years ago? I do not know, but I intuit that there is a reason, and it is significant. Imagine that individuals join after coming to an epiphany that they must grow their business in order to pull themselves out of poverty. Or perhaps participants join when everyone in their household is healthy, and hence does not need constant care in the home. Such a situation suggests that perhaps access to credit is not the problem, but rather access to good health care. If ample opportunities exist for credit and savings in their community, then attributing the improvement in their lives to the microfinance institution would be erroneous. Their epiphany or their family’s health should get full credit.
One way to address this problem is to analyze the alternatives for credit and savings that clients have in their communities. Since social networks can create both credit opportunities (e.g., informal loans) and savings opportunities (e.g., Rotating Savings and Credit Associations, ROSCAs), evaluating a client’s next-best alternative is not an easy task. Further research to understand the informal opportunities to borrow and save is essential for understanding the seriousness of the timing problem.

Peer Selection Problem

Imagine banks form through a process like a draft for sports players. The best candidates get drafted first, the good-but-not-best candidates get drafted second, and so. Theory suggests (Ghatak, 2000) and evidence supports (J. Hatch, personal communication, 1997) that individuals are selected into banks in just this way, assortatively by quality of participants, where wealth is used by peers as a proxy for quality. Hence, one group to form in a community contains the best off; the second will be slightly less well off, etc. Again, without any impact at all, a naïve cross-sectional analysis would find veterans have higher wealth than new participants and would attribute this difference to program impact. In fact, if one is targeting the poorest of the poor, then finding positive impact through this method suggests failure since it suggests that perhaps the wealthier are always served first. This issue is heightened by the SEEP/AIMS practitioner-tools because their tools specifically instruct practitioners to use two-year-old banks for the two-year-old veteran pool, one-year-old banks for the one-year-old veteran pool, and new banks for the new entrant pool.

The point of the above story is not limited to the stylized case provided. Take the following scenario as another potential situation. The poorest join first because they are the ones willing to take the risk of participating in this unknown project. Next come the better off clients who only moved once they saw the product tested. Then come the middle tranche. In this scenario, comparing new entrants to veterans will underestimate
impact, since the veterans will have started out poorer than the new entrants.

**Institutional Dynamics**

Microfinance institutions change their strategies and/or client identification process, and such changes could affect materially the composition of a new versus veteran participant pool. If any such change systematically alters the relative wealth or income of the new versus veteran participants, again a naïve cross-sectional analysis would erroneously attribute differences to impact. I will discuss two plausible scenarios, both of which I have witnessed in the field.

**Program Placement**

Microfinance institutions typically have a multi-year strategy for which communities to enter and why. Suppose, quite reasonably, that a young microfinance institution prefers to start out cautiously, and hence enters slightly more well-off communities. Then, after achieving comfort with the local culture, economy, and business practices, the MFI branches out to the poorer neighborhoods. In this situation the veteran participants would all be wealthier than the new participants even if the program has no impact. Hence, a naïve cross-sectional analysis would erroneously attribute impact to the program success. The SEEP/AIMS practitioner-oriented tools try to address this issue by instructing practitioners to choose similar neighborhoods. Assuming the similar communities exist, this might work, but if the implementation plan follows the pattern described above, similar-enough neighborhoods simply might not exist. This becomes a timing issue for the practitioner: at what point in the implementation of the plan will the practitioner learn that no valid control communities exist?

**Changes in Credit Requirements**

Just like banks, MFIs often respond to changes in the economy by tightening or loosening their credit requirement. In a recession, when even microentrepreneurs are hurt, MFIs might be
more stringent about the credit criteria for participating. Or perhaps they are more lenient. If tighter credit requirements effectively filter out the poorest of the poor, then individuals who join during a recession will be better off than those who join in a normal or boom time. Or if policy becomes more lenient, individuals who would not have previously received credit now do. If the impact assessment is being conducted in the middle of a recession, and two years earlier the economy was either normal or in a boom, then the new participants will be more well off than the veteran participants. In this situation, a cross-sectional analysis will underestimate the true impact of the program. Or if policy becomes more lenient, the analysis will overestimate the true impact of the program. The point here is not which direction the bias is, but rather that this approach to impact assessment demands that no such policy change is made, whereas reality dictates that policy does change as the economy changes.

Solutions
The dropout biases are particularly important when attrition is high. Both dropout problems are solvable within the constraints of the one-shot, cross-sectional AIMS approach. Although the current SEEP/AIMS tools do not address the problem, a change to the sampling technique can solve both problems. Conceptually, the two samples are not the same: the veteran group consists only of those who remain, whereas the new member group consists of members who will drop out. One can alter the veteran group to include those who drop out, or can alter the new member group to include only those expected to remain. The first approach is far better and solves both of the problems. The second approach requires some econometric work and solves only the second problem.

As discussed earlier, one major issue is that those who drop out probably were impacted differently than those who remain, and any analysis which ignores them is akin to cherry-picking one’s successes, ignoring one’s failures, and then claiming victory. The solution requires conducting the “veteran” survey on
a sample of members who were in the bank two years ago, some of which are still present but others of which have dropped out. Then the analysis which compares consumption and income levels across veteran and new groups would include the complete “veteran” pool. This approach solves both the incomplete sample and the biased-dropout problems. It would be important when implementing this approach to sample randomly the veterans to interview (not just pick those easiest to contact) and to pursue them diligently. A recent study in Indonesia found that the extra effort to pursue the difficult-to-find pays off tremendously, as these individuals are significantly different from those who remain in their neighborhoods and are easy to reach (see, for example, Thomas, Frankenberg, Beegle, and Teruel, 2000).

The second approach requires combining the data on the veteran members and the dropouts to attempt to find predictors of dropout. The predictors must be observable when someone enters since they will be used to predict which new members will drop out. For instance, distance to the meeting place, number of family members in the lending group, age of business, history of prior credit use, and history of prior savings are all observable and plausibly predictive of dropout. Using this information, one would then use econometric tools to predict who will remain amongst the new members, and then weight the new entrant sample according to their probabilities of remaining. As long as poverty is correlated with some of the observable information used to predict dropout, this solves the second dropout problem. However, this does not solve the first problem discussed, since we have simply modeled who will drop out, not who will have the biggest impact. The veteran sample still contains only those with positive impacts and ignores those with negative or no impact.

Conclusion
The impact evaluation debate rages on in microfinance. Some believe all impact evaluations are useless, but targeting evalua-
tions are appropriate to ensure at the minimum that the clients are the intended recipients. Others believe that mid-level impact evaluations, such as the one analyzed here, are useful and informative. As this paper highlights, the dropout biases inherent in a cross-sectional impact evaluation are problematic but solvable. However, the selection and institutional dynamics problems are more difficult. Depending on the circumstances in a given project and economic setting, these issues suggest that any findings cannot be attributed easily to the project, and hence the cross-sectional approach is not appropriate. A solid understanding of the selection process, economic environment, and institutional dynamics is important in deciding whether or not to employ this mid-level, cross-sectional approach.

An alternative to mid-level impact assessments would be a two-prong approach, with many “targeting” evaluations and a few methodologically rigorous longitudinal evaluations. The “targeting” evaluations would be small, frequent tools which monitor client targeting (but do not claim to measure impact), combined with institutional analysis which examines, from a management perspective, the efficiency and flexibility with which a program delivers its services. The longitudinal studies would have proper control groups, which follow all members, including dropouts. Such projects could inform the rest of the microfinance community about proper targeting, impact, and mechanism design issues. Ideally such studies also would test different product designs, so that one could assess the differential impact of one product over another. Organizations which conduct such studies would be contributing to a public good, wherein other MFIs can learn from their studies and learn how to target better and design better products so as to achieve their primary goal, poverty alleviation, more effectively.

Creating a control group in a longitudinal study does not necessarily imply impositions to operations. This author, for instance, is currently working on a longitudinal impact study in urban South Africa, where the control group is randomly cre-
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ated and hence strong methodologically. The process is of little to no cost, and is even a benefit, to operations. The strategy took advantage of the natural organizational limitations of a project as it entered a new area. Not all MFIs are in the situation to do what is necessary to conduct such a study, but if enough are, and the studies are conducted, then we as a community can learn more about whether MFIs can alleviate poverty, who we can help the most, and how we can best help them.

Notes

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1. The author bases the analysis of the AIMS tools on his personal observation of the evaluation tools being implemented by AIMS for FINCA-Peru, and the draft version of the practitioner tools manual.

2. Specifically in the case of FINCA International, Hatch found that older banks invited wealthier individuals to participate than did younger banks, and that new banks in old areas were poorer than old banks in old areas.

3. Proper control groups are particularly difficult to create for microfinance impact studies since the entrepreneurial spirit of participants is presumably quite unique. Hence, merely finding "similar" individuals as a control group does not solve this problem.

References


Rethinking the Approach to the Microenterprise Sector in Latin America

An Intergrating Framework by Jaime Ortiz

Abstract: Unavoidable macroeconomic adjustment policies have exacerbated social inequalities in Latin America. As a result, electoral platforms have identified microenterprises as an alternative economic activity to help alleviate poverty. Pursuing an efficient microentrepreneurial base requires from governments a comprehensive package of both financing and training strategies. Conversely, microentrepreneurs require a better understanding of their activity in order to set forward arguments that will allow them to enhance their management practices. Government policies towards the microenterprise sector should create favorable conditions conducive to the establishment and operation of financial institutions as well as specialized nongovernmental organizations providing training and consulting. Within that framework, this article attempts to raise awareness of the managerial and policy implications of the interactions between financing and training in affecting microenterprise performance.

Introduction

Microenterprises are generally understood as the very small, informally organized, nonagricultural businesses operating in less-developed countries. Ten is the upper bound of employees used by several international organizations as a threshold to distinguish them from small enterprises (United Nations,
Microenterprises have widely been recognized as an engine of economic growth and a source of sustainable development. In Latin America, microenterprises are alternative or supplementary sources of income and employment (Pfeffermann, 2001). Microenterprise activities are seen as an effective means of relief for the most disadvantaged members of society. The contribution of microenterprises in generating employment, production, and value added is characterized by a high degree of flexibility in unstable economies. In some countries, trade and services from microenterprise and small enterprises contribute as much as 35% of the gross domestic product (Inter-American Development Bank, 1999).

As a result of its rising significance, the microenterprise sector is demanding a greater voice in shaping sectoral policies and assistance programs. There is a tendency among microenterprise advocacy groups, however, to neglect the fact that problem-solving strategies must take into consideration a combined financial and training perspective. Governments have responded to demands from the microenterprise sector with an array of unrelated policy instruments. This is equally true of interventionist approaches adopted by countries like Colombia where borrowers are required to undertake some training as a precondition for receiving financial assistance and more “laissez-faire” attempts undertaken by countries like Ecuador, where training assistance packages are paid fully by each beneficiary in order to reach program sustainability.

Brugger and Rajapatirana (1995) stress the importance of specific government policies and programs aimed to promote an efficient use of productive factors such as capital and entrepreneurial skills. The typical perspective is that a market-oriented policy setting offers ideal conditions for microbusiness cre-
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Stable fiscal and monetary policies have resulted in reasonable inflation and interest rates. By the same token, financial transparency has provided incentives as well as mechanisms to attract savings and channel them into productive investments (Gray and Gamser, 1994). Thus, macroeconomic reforms instituted in some Latin American countries have created a cradle of microentrepreneurs that is now more confident and eager to start new business initiatives. In this context, widespread promotion of microentrepreneurship is a grassroot oriented approach to reducing the social problems of poverty and unemployment. An added payoff is that microentrepreneurs constitute a class of inherently politically conservative and socially stabilizing citizens. However, global competition threatens this fledgling sector. Unless microentrepreneurs adopt a strategy for building their competitive resources, the continued viability of this sector will be threatened.

This article argues that successful promotion of the microenterprise sector requires the integration and linkage of technical training with financial assistance programs. It is also argued that any attempt to improve the quality of both lending and training services requires the identification of basic as well as more sophisticated managerial practices. Specialized non-governmental organizations (NGO) must stimulate adoption of appropriate instruments to meet the combined demand for loans and microentrepreneurial training. In that context, policy instruments for strengthening microenterprises must combine and leverage the interactions between financing and training strategies.

This article explicitly considers some policy strategies to be taken into account by specialized NGOs and microentrepreneurs in order to defend the recommendations given. The first section identifies the basic problems faced by a number of Latin American countries when providing lending services to microenterprises. The following section justifies the importance of integrating financial and training issues. It concludes
with a conceptual framework for implementing the recommendations offered. The last section summarizes the policy options available to governments in the way of “social investments” addressed to encourage the microenterprise activity.

**Problem Identification**

International lending organizations have carried out extensive technical assistance programs supporting the microenterprise sector. However, inadequate technical assistance services seem to be the most serious obstacle for strengthening the microenterprise sector in Latin America. Of note, in the most advanced countries such as Brazil and Chile, the intensity and effectiveness of past microenterprise business assistance models seems to have lost momentum (United Nations, 1997). Recent evaluations of lending programs to microenterprises emphasize the mistake of having minimized and/or omitted training needs when financial assistance initiatives are undertaken (Inter-American Development Bank, 1999).

Latin American economies are characterized by ongoing privatization processes, incipient industrialization levels, and market-oriented institution building. Within that scenario, successful microentrepreneurship is only possible if training mechanisms are developed and offered by institutions already dealing with the microenterprise sector (Gray and Gamser, 1994). Specialized NGOs are the kind of institutions willing to respond to the training needs of the microenterprise. Broadly speaking, they are professionally managed, self-sustained institutions fully capable of instilling comprehensive management training methods in microentrepreneurs (OECD, 1995). Specialized NGOs focus on effectively enhancing the technical acumen of microentrepreneurs, as a precondition for gaining access to financial services. Therefore, they must be considered an essential part of a thorough implementation plan to create cost-effective and self-sustained microentrepreneurs capable of competing more effectively.
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However, the role and credibility of NGOs as specialized, nonpublic technical entities need to be strengthened, mainly because financing programs have performed poorly in the past, and because of a natural distrust from commercial banks of new lending programs (Ortiz, 1996). In fact, it is not surprising to find some banks reluctant to be targeted as main actors for channeling funds toward microentrepreneurs (Otero and Rhyne, 1994). Therefore, a go-slow approach deferring institutional assistance would jeopardize the success of future lending programs regardless of the financial instruments designed to spread microlending (Gadway, 1991).

Justification

There is some empirical evidence that assistance programs that simultaneously apply financial and training programs disproportionately increase the success of technical assistance programs addressed to microentrepreneurs (United Nations, 1997). This shows that when training needs are addressed, microentrepreneurs can achieve significantly greater resource allocation efficiency. Ortiz (1996) concludes that training programs not only need to be understandable to microentrepreneurs but also relevant to their specific business problems. The implication is that any lending initiative must necessarily be associated with training in topics related to basic managerial skills for the activities for which financing is needed. As an example, a firm wanting to export branded instead of bulk Chilean wine should be assessed for its brand marketing skills as part of the financial evaluation process, and proactive training and counseling would be included in the marketing assistance package.

Thus, technically sound assistance programs should allow business training NGOs to develop an array of training programs for microentrepreneurs that will ultimately improve the quality of their clients’ business decisions. A complicating factor is the relative weakness of financial markets in Latin America. This in effect eliminates options that are customar-
ily available in developed nations. Despite financial sector liberalization, venture capital for funding technology-based high risk and high return endeavors is unavailable in most Latin American countries (Behind America’s story, 1997). Since microenterprises are still perceived to be riskier than medium and large firms, joint ventures in the form of strategic alliances, licensing agreements, or franchises remain relatively unavailable to venture capitalists (OECD, 1995). In essence, microenterprises in Latin America are greenfield, stand-alone projects without protective umbrellas to which their counterparts in developed nations can turn. This means that guaranteed lending programs channeled through the banking sector are the most realistic avenue.

Governments therefore need to step into the arena to help build up linkages among nongovernmental training organizations and lending institutions. A number of those specialized lending institutions in Latin America should capture past experiences to come up with training packages to revitalize the current situation. There is some evidence provided by Gadway (1991) that commercial banks would multiply their services to microenterprises if appropriate incentives were in place to further reduce risk through training activities. Conventional wisdom prioritizes the capacity of financial institutions to capture savings that may be directed to investments with high private and social returns.

A Snapshot of Selected Nations
Uruguay’s experience in strengthening microenterprises through microlending and training is noteworthy. Microenterprises represent about 84% of all private enterprises and provide jobs to 33% of the economically active population (Urrutia, 1997). Privatization attempts undertaken since the early 80s were seen as the main objective of an overall economic strategy, instead of a comprehensive economic policy reform leading to a more efficient and strong private sector. As a result, the National Office of Micro and Small Enterprises was created
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by a law decree to anticipate imbalances in long-term development of the microenterprise sector. Its purpose was to plan, coordinate, and execute promotional and development activities for micro and small enterprises. An Honorary Committee made up of representatives of seven prominent interest groups and/or economic sectors had an advisory role in supporting, informing, and promoting technical change throughout the micro and small business sector. Special emphasis was given to ensure that technical assistance programs would be jointly directed to support both local lending institutions and specialized training organizations. Urrutia (1997) holds the view that the aim was to build up synergistic relationships of commercial banks and NGOs to successfully enhance microenterprise development. However, the true challenge for the Uruguayan institutional strengthening program rests on whether, at the end of the day, technical assistance was focused on the distinct needs of each microentrepreneur. This would allow financial institutions and nongovernmental training organizations to substantially improve specific financing agreements, credit restructuring, and distribution of financial spreads.

In Brazil, the Serviço Brasileiro do Apoio às Micro e Pequenas Empresas (SEBRAE) is the most significant technical institution in charge of encouraging entrepreneurial activity and developing supporting programs and projects. Its aim is to work in an innovative and practical fashion to facilitate a sustainable evolution of micro and small enterprises. SEBRAE was created in 1990 along with the national confederation of industries from all productive areas. In recent years, however, it has weakened its links with main research and development agencies. It has become a massive bureaucratic organization, and its efficiency and effectiveness has been seriously undermined. Despite being private and autonomous, SEBRAE has redirected its goals and objectives to financial aspects of microenterprise activity. Its attempt to achieve nationwide technical coverage has been diluted as it has moved away from training (SEBRAE, 1999).
Chile deals with microenterprises from another highly distinctive bureaucratic angle. The administrative and regulatory procedures of the state agency Corporación de Fomento de la Producción (CORFO) excludes nongovernmental organizations altogether as channels of public sector support except in the limited role of suppliers of a specific type of technical assistance as determined by CORFO. Initially, a CORFO team works directly with the microenterprise sector to identify its need for productivity and quality improvements. Then, a working plan is developed which must explicitly incorporate new productive processes aimed at efficiency gains and/or quality increases. Finally, CORFO itself lends micro and small businesses up to 50% of the cost of technical assistance requested to hire individual consultants or consultancy firms that have previously been registered (CORFO, 1999). Financial intermediaries are left out of the picture as CORFO only funnels financial resources through private commercial banks. Under such a decoupled mechanism CORFO fails to address the much broader complexity in which microenterprises operate. Likewise technical assistance NGOs act merely as subcontractors and have no real input in defining training needs.

By the late 70s, the Colombian industry had exhausted its capability to create enough jobs to absorb a growing urban labor force. It took some time for the government to acknowledge the importance of the microenterprise sector in terms of industrial restructuring and labor productivity. The absence of a legal framework, scarce financial resources, and a lukewarm commitment were the initial hurdles to developing the microenterprise activity. In 1984, the Ministry of Economic Development along with the National Planning Department launched a comprehensive set of policies and programs addressing the needs of the microentrepreneurial sector. Direct technical assistance and financial support provided under favorable conditions have both allowed microentrepreneurs to fund business start-ups, expansion, equipment purchases, or working capital. This government-sponsored package still prevails and
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has successfully positioned itself mainly through credit promotion, entrepreneurial enhancement, grassroots organization, and marketing training (Guerra de Mesa, 1996).

Ecuador, on the other hand, has begun to deal with the microentrepreneurial sector from a highly distinctive ideological angle. Over time, it has emphasized the role of the market in shaping the allocation of financial and nonfinancial resources within an inherently complex bureaucratic framework (Placencia, 1999). In effect, the institutional and organizational support from the government is viewed as being specific and temporary in nature. An inefficient bureaucratic network and lack of readily available public resources were both skipped by the majority of commercial banks. Currently, microlending is almost exclusively provided by the latter. As risk management institutions, commercial banks only extend credit to microentrepreneurs providing evidence of both collateral and training. NGOs act as intermediaries between commercial banks and microenterprises by providing several forms of technical assistance. They offer training and information services at fees that closely reflect their delivery costs, in part, as a condition imposed by the international financial community. Results in terms of microenterprise competitiveness and growth remain uncertain, especially because Ecuador still continues restructuring its economy by making deep reforms in the financial and banking sectors.

A more holistic approach to tackle the lack of management training among microentrepreneurs is surely needed. Figure 1 presents the social, legal, economic, political, and technological environment that shapes the general framework for identifying technical assistance policies directed to the microenterprise sector. Following Krueger and Brazeal (1994) as well as Walsta and Korilsky (1996), a crucial decision process takes place within the private sector. Namely, financial and training institutions must get together to identify problems and needs faced by the microenterprise community. Feasible
financial and training strategies should then be defined and, subsequently, provided.

**Implementation: Toward More Effective Integrated Support Programs**

The contrast between what has been reviewed and the success of the Association of Industrialists from the Perugia Province in Italy (ASSINDUSTRIA) in implementing micro and small entrepreneurial programs may serve here as a leading example. Steered by a powerful entrepreneurial force, ASSINDUSTRIA services a vast army of potential and existing microentrepreneurs. First, it firmly assists, protects, and represents their
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interests from a social, legal, economic, and political point of view. Second, it actively encourages those microenterprise initiatives that improve competitiveness. Finally, it takes the lead in promoting both the formal and informal entrepreneurial and professional education of its associates. Using a comprehensive approach to understand the ultimate interests and priorities of its clientele, ASSINDUSTRIA provides specific industrial subsector information to improve microenterprise performance. It periodically releases the updated market, financial, and technological research findings of its staff members and other associates. Specific technical assistance is provided to its constituency in areas such as manufacturing, logistics, and consumer behavior. The results obtained from this exclusively private federation model are impressive. It is claimed that more than 75% of its members have successfully been able to handle their investment decisions when their loan requests have been accompanied with specifically tailored training programs (ASSINDUSTRIA, 1999).

Rather than one-shot deals, as with CORFO, or disarticulated approaches, as with SEBRAE, training programs should be offered on a continuous, tailored basis to earn credibility and sustainability. The programs should be client driven. An assortment of educational tools for a wide range of needs is essential for microenterprises to gain a competitive edge. Events must be fully customized to address the interests and expectations of microentrepreneurs in different sectors or experiencing different needs. Ideally, business training NGOs, not governmental bureaucratic entities, should be in charge of coordinating seminars, workshops, and conferences offered by the instructors being hired. Thus, it becomes necessary to prepare subjects, contents, methodologies, coverage, and costs of specific training programs (Freudenthal, 1996).

Financial institutions with the help of supervisors will focus on the most promising financial services. Loan managers should be able to identify the economic activities to be funded while a training team prepares management training modules.
The advisory team will accomplish the loan objectives based on clearly stated terms of reference. It should be understood that those terms of reference may be adjusted and complemented based on the characteristics of participating institutions.

From the supply side of training, it is necessary to consolidate a roster of microenterprise instructors and/or consultants in areas relevant to the formulation and implementation of business development programs. They would offer seminars, workshops and courses and develop training events. Conversely, on the demand side for training, a database of microentrepreneurs classified by name, address, sex, educational level, type of economic activity, assets, terms, and loan sizes is needed to undertake an exhaustive analysis of the eligibility conditions for training. The support of NGOs leaders in the creation, expansion, and strengthening of training services

**Figure 2**

*Proposed Training Module Progression*

1. Building Basic Skills
2. Developing Management Skills
3. Solving Production and Operating Problems
4. Modernization and Expansion
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to a growing microenterprise community envisions, but is not limited to, the sequence of modules shown in Figure 2.

The training program suggested here is centered around four core modules. It touches on key managerial areas affecting microenterprise competitiveness. Essentially, the training program focuses on creating products or services for changing market conditions, identifying investment opportunities, and turning them into actual business. These modules are adaptable to the specific needs of microentrepreneurs. They cover a wide range of topics such as the business environment, information technologies, managerial techniques, and international trade and finance. One of these, for instance, discusses the role of political institutions in advocating the needs of the microentrepreneurial sector. A better understanding of the policymaking process is important as it helps microentrepreneurs to lobby for initiatives and reforms that will favor them. The success of each module relies heavily on the presence of a body of highly competent instructors and/or consultants as well as strongly motivated microentrepreneurs. By the end of the training program, microentrepreneurs should be able to successfully put into practice the acquired knowledge and managerial skills. These modules and their corresponding submodules are:

1. Building Basic Skills: This module should be considered the first step leading microentrepreneurs to perform more effectively in society and, ultimately, increase microentrepreneurs’ incomes and assets. It should introduce the practice of identifying, leveraging, and creating microenterprise opportunities. Understanding the economy becomes imperative as the marketplace becomes increasingly complex and competitive. This module would concentrate on the following specific topics:

   - Functioning of the social and legal environment
   - Interactions between politics and economics decisions
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- Financial and cost accounting
- Market research and marketing concepts

2. Developing Management Skills: This type of module should make microentrepreneurs aware of the powers and limitations of different types and uses of information systems. At this level, microentrepreneurs should internalize basic principles aimed at raising their overall management skills. Personnel and labor relations also need to be covered to understand the microenterprise organization. Key issues under this module would be represented by:

- Business plan preparation
- Planning and production control
- Human resources administration
- Leadership and motivation

3. Solving Production and Operating Problems: This module should offer more advanced elements of microenterprise management focusing on the critical factors of successful business operations. Its primary goal is to instill the concepts and importance of innovation for successful productivity gains. The operational contents for this module would be:

- Creativity and innovation
- Productivity assessment
- Programming information systems
- Information technology, Internet, and E-commerce

4. Modernization and Expansion: This module should sharpen the previously acquired skills and experiences of the microentrepreneurs. This final step aims at reaching financial sustainability and further adherence to standard management practices. Managerial processes and decision-making techniques must be available to those eager to explore more advanced topics. This module would be characterized by the following subjects:
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- Total quality management
- Investment decisions
- International trade
- International financing

Some degree of generality and standardization in the training modules above is immediately acknowledged. However, the existing literature on micro and small enterprises repeatedly cites them. These topics represent the broadest assortment of subject areas from which a streamline customization can be accomplished to the specific needs of individual countries and economic sectors. The implementation of those training modules should be the NGOs’ responsibility. Those organizations should arrange training events in such a way that by participating along with their financial entity counterparts, both microentrepreneurs and lenders can work synergistically. Activities from the financial services side should also include direct support to microentrepreneurs through specific agreements with NGOs to diversify the management advice required. Nongovernmental training entities must receive logistic support in the form of equipment, communications, and publications in order to guarantee a smooth implementation. Since the needs of microentrepreneurs are so varied, NGOs should also become better at recruiting, evaluating, and compensating instructors and/or consultants. In a similar fashion, local financial institutions should (1) be entrusted with the names of the nongovernmental training organizations involved in the implementation of the technical assistance programs, (2) receive present reports according to the established terms of reference, and (3) incorporate suggestions and recommendations made by the international lending organization.

International lending organizations have consistently shown a strong commitment to microenterprise enhancement in developing and transitional economies. They have had a crucial role in creating partnerships with national agencies that
encourage local entrepreneurship, promote self-employment, and help local economies to realize a sustainable development. Examples of international lending organizations harbored under the United Nations system are the Inter-American Development Bank, the World Bank, and the United Nations Development Program. They have developed the capacity to carry out their mission by effectively assisting policymakers in designing and setting up microenterprise programs. It seems logical then to capitalize on their substantial field experience accrued in the microenterprise sector over the years. Besides, capital shortages faced by most less-developed countries prevent, in most cases, establishing microenterprise programs without the involvement of these international financial and technical entities.

The strategic aspects of both technical training and management advisory programs need to be monitored by an executive board. It would consist of managers well qualified by virtue of their academic background, professional expertise, and business skills coming from both commercial banks and specialized NGOs. The executive board will offer through careful deliberation suitable and practical solutions to address problems encountered. For instance, it may suggest a systematic approach to identifying training needs, optimizing financial portfolio diversification, or streamlining of lending requirements. It will also recommend immediate adjustments when follow-up procedures indicate unaccomplished goals. On a quarterly basis, the executive board will inform the international lending organization about the advances and obstacles of each financing and training program. On the financial side, its report would include detailed information on disbursements, numbers, and type of characteristics and beneficiaries as well as programmed and accomplished events. On the training side, its report would include indicators such as the number of seminars, workshops, courses, and training events offered; the number of attendees; the or subjects and/or disciplines covered.
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The presence of an executive board is even more compelling in cases when international lending organizations are not involved in formulating and implementing a microenterprise program. Its mission is to tighten cooperation among specialized NGOs and commercial banks in order to spur microentrepreneurship. The idea is to emphasize networking and promote capital raising and marketing activities among participating entities. An executive board of that sort will seek out business partnering involving relationships with academic institutions and research and development centers. These agreements will complement the microenterprise program with resources and technologies it would otherwise lack. The strategic and operational directions given by the executive board will also add value to the microenterprise program carried out by specialized NGOs and commercial banks.

Monitoring is an essential step of the implementation. The purpose of monitoring is to verify compliance with the terms agreed to by the borrowing institution with the international lending organization. Before technical assistance programs end, the international lending organization will advise its counterparts in designing an ex-post evaluation methodology. Such an input will prove useful in order to improve the design and implementation of future technical assistance programs. In turn, it will allow measurement of the effects and impacts of financial institutions and nongovernmental training entities on the microentrepreneurs themselves.

Conclusions

Deregulation and liberalization processes undertaken by several Latin American governments call for specific policy options aimed at strengthening their microenterprise sector. Countries which have maintained positive attitudes towards this sector have experienced less severe social problems (OECD, 1995). Public support for the microenterprise activity results in stronger and more dynamic private sectors capable of meeting the challenges of a globalized economy. A competitive
economic environment based on microentrepreneurs requires better management practices and the adoption of increasingly efficient technological processes. It becomes imperative that Latin American countries restructure both financial and nonfinancial assistance programs to capture in a meaningful manner the heterogeneity of microentrepreneurs.

Government policies towards the microenterprise sector should create favorable conditions conducive to the establishment and operation of financial institutions as well as specialized NGOs providing training and consulting. Microentrepreneurs would have access to more profitable market segments if their financial needs and training requirements were jointly addressed by governments. Within that context, microentrepreneurs need to adopt best practice innovative management programs. Sustainable transfer of knowledge by specialized NGOs will certainly facilitate increases in production capability and competitiveness. Efficiently administered financial resources of both national and international origin will also help to reduce the risks involved in carrying out microenterprise activities.

An alternative strategy would be to offer financing and training services through preexisting networks of lending and high-learning institutions in those Latin American countries where the social, legal, economic, political, and technological environment permits. Under such a scheme, microlending units of commercial banks along with academically competent business service providers could be replicated to provide financial assistance and training program opportunities to current and prospective microentrepreneurs. Such a policy option requires further development in terms of country selection, model appropriateness, and/or implementation advising. This issue falls, however, beyond the scope of this article and is left for further research.
Rethinking the Approach

Notes
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Journal of Microfinance


Financial Performance of Selected Microfinance Institutions

Benchmarking Progress to Sustainability

by Michael Tucker

Abstract: A few microfinance institutions (MFIs) have implemented best business practices and made the transition to fully regulated financial institutions. Many more are in the process of undertaking this transformation or at least considering it. Rising competition among growing numbers of MFIs for both funding and clients has made improved financial performance a necessity for most if not all MFIs. Financial ratios of 17 Latin American MFIs are compared to benchmark performance ratios for the industry and with commercial Latin American banks. This small sample of data, while useful, also underlines the need for more widespread MFI reporting. Complicating reliance on financial comparisons is a complete lack of standardized measures on how well the poor are being served.

Introduction

With initial and ongoing subsidization, microfinance institutions (MFIs) have been able to operate for years without too much pressure to comply with the best or most profitable operational strategies. An increase in competition and the emergence of an ability to compare the financial performance
of MFIs with each other and to benchmarks is beginning to create greater concentration on improving business practices. Realization that more efficient and financially sustainable MFIs may also in the end lead to the assistance of a greater number of the poor has served to link improving business practices with social mission. A shift in defining that social mission may, however, be underway at some institutions as profits grow in importance. Measuring and comparing the performance of MFIs has been difficult due to both a lack of publicly available financial information and differences in reporting in a mostly nonregulated industry. Data used in this overview has been limited but it does indicate movement toward some standardization and the emergence of the ability to make benchmark comparisons.

Financial Sustainability

As more of MFI financing has come in the form of loans at below market interest rates instead of outright grants, the providers of low interest loans have found that their fiduciary responsibilities necessitated greater scrutiny of the financial practices of recipients. Even for NGOs still providing outright grants, the task of determining which MFI to fund becomes more of a business decision as the number of MFIs has grown. Social goals may be more efficiently and effectively met by MFIs familiar with best business practices as well as willing to adhere to free market norms of making their operations transparent to would-be lenders or donors. In the absence of standardized, well-reported indicators of how well MFIs serve the poor, the only measures available are financial ratios.

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Financial Performance

If an MFI is examined by a competent auditor verifying the accuracy of financial information, it is then possible to compare its performance with that of other MFIs. Benchmarks as a means of comparing how well individual MFIs are functioning within their peer groups is a useful tool for MFI management and potential lenders or investors. The MicroBanking Bulletin and MicroRate in conjunction with other organizations provide comparisons on a variety of ratios across regions of the world as well as categories of MFIs. These benchmarks are a means of comparing the performance of MFIs on their ability to use funds efficiently. Whether or not targeted clientele are funded has not been as clearly a focus of data gathering, though at least the level of poverty of clients can be deduced from the size of the average loan.

Not all MFIs may want to publicly reveal their financial data, particularly those that are less efficient or perhaps less capable of complying with reporting standards. There is a reluctance to supply data to create and expand a benchmark reporting system that is in its infancy. This reluctance to participate by the vast majority of MFIs means that the data that is reported is skewed toward more successful and usually larger MFIs. Larger MFIs with better financial performance and/or more accurate record keeping would likely be more motivated to respond to data gathering. The September 2000 MicroBanking Bulletin (Calmeadow, 2000) had data from only 114 institutions out of several thousand. Among the missing MFIs is the very large Grameen Bank with over 2.5 million clients. Only 23 out of the 114 that did report were willing to release their individual figures on a disaggregated basis to the public. A considerable number of those institutions were regulated and already legally required to release their financial figures.

Incremental costs in time and money to comply with reporting requirements are likely one barrier to reporting. Another is the lack of requisite data maintenance and administrative skills. One way that low participation rates might be
addressed would be for NGOs to compel the participation of their client MFIs. Since most NGOs that either loan or provide grants to MFIs usually require periodic audits, it would seem to be a fairly straightforward step to insist that client MFIs report data to independent rating or data compilation services in order to be eligible for funding. Greater transparency would create a more open market for funding allocation, enabling the most efficient MFIs to survive. A danger in this strategy is that the social mission could be compromised. Serving the poorest is more expensive than servicing the poor or the near poor. At the very least, making available demographics of the client base along with financial performance would allow either for data gathering groups to make adjustments to take the poverty of those served into account or for NGOs to make their own allocation decisions with a full complement of information. It may also be possible for institutions not seeking financial sustainability to take the initiative to develop a different set of benchmarks derived from social audit data. This standardized data would assist NGOs in allocating funding to MFIs that more clearly meet their goals.

Competition

Competition for grant and loan funds has increased as the number of MFIs has steadily grown. A more recent form of competition has been the pursuit of clients. This coincides with the growth in the number of MFIs. Attracting clients involves marketing to their needs rather than simply distributing money to the next customer.

Somewhat taken for granted as an inexhaustible resource, clients were seen as readily available if the MFI had the funds to loan. In an economic environment where MFIs were few, they did not compete with each other but rather allocated territory and/or clients if more than one MFI was in the same geographical area. With the profusion of MFIs this type of collusion is no longer viable and may even be construed as illegal in countries seeking more open markets. As MFIs strive to
become financially sustainable, market share is increasingly important. For profit making businesses, gaining market share has been the most certain route to economies of scale while simultaneously overcoming the competition. In the MFI world, this can be accomplished by attracting more clients, increasing the size of average loans, or both.

With the entry of banks as lenders to the poor as well as MFIs making the transition to regulated financial institutions, interest rate competition to attract clients and profits to lure investors are important operating considerations. In 1995 the poor in Latin America were virtually ignored by regulated entities who obtained nearly 100% of their credit from non-regulated MFIs. By 2000, 53% of clients who would have been customers of unregulated MFI are now customers of regulated MFIs or banks (Christen, 2001). In that interim period several MFIs made the transformation into regulated institutions or banks, taking their clients with them. PRODEM in Bolivia became Banco Sol and took on more expensive unsubsidized credit from banks. The size of Banco Sol’s average loan increased, reflecting an attempt to become more cost efficient. A new lending requirement was also instituted that mandated borrowers would not be eligible for loans unless they were in business for one year or longer (Cerven, Ghazanfar, and Source, 1999).

The average loans made by regulated MFIs in Latin America are greater than loans made by unregulated institutions: $803 for regulated MFIs versus $322 for unregulated MFIs (Christen, 2001). Larger loans made to more prosperous clients in an effort to achieve cost effective operations support the notion that mission drift is occurring; i.e., the original goal of service to the poorest may be undergoing a transformation by a very real need to become both financially sustainable and competitive. Lending small amounts of money is time and cost intensive. The cost of a loan to a first-time borrower, including attracting that borrower, has been estimated to be from $55 to
Increasingly banks have recognized the possibility of profits in microfinance and have expanded their retail services to include lending to the poor (Baydas, Graham, and Valenzuela, 1997). Individual MFIs are faced with competitive pressure from above coming from banks expanding into their markets seeking their better clients. Competition from below for the poorer clients is coming from new or expanding MFIs. In the third quarter of 1999, 163% of the Bolivian MFI market had been reached (Christen, 2001). The only explanation is that market saturation has led some borrowers to borrow from more than one MFI. Competition on both quality of service and the cost of delivering that service are major factors in some MFI markets. A shakeout of less efficient MFIs is underway. Those that survive are likely to be the ones that are more client centered.

In Nicaragua MFI interest rates are typically 30% to 40%, considerably higher than commercial bank rates of less than 17%. In 2001, an election year, a new law was passed mandating that MFIs charge rates no higher than those of commercial banks. Regulated financial services are not constrained by the interest rate ceiling, obviating the need in Nicaragua for MFIs to become more efficient where possible, compete for more prosperous clients and more seriously seek to become regulated financial institutions (personal communication with F. Barquero, consultant to Wisconsin Coordinating Council on Nicaragua, 2001). A key requirement of a regulated financial institution is that it must demonstrate the ability to earn a profit. Regulated financial institutions must also meet timely reporting requirements, use acceptable accounting practices, and are subject to periodic audits. These are all difficult goals for fledgling MFIs that may lack the personnel to achieve them. Technology can assist to some extent.
Technology

Servicing ever increasing numbers of clients demands more sophisticated management information systems (MIS). Many MFIs have struggled with outdated software, often locally made without documentation or adequate support. Acquiring software to run a larger organization can be expensive—one of the more highly rated software packages, SIEM, is priced from $2,000 to $20,000 (CGAP, 2001). Keeping hardware up-to-date and training expenses increase the outlay. In addition, the need for more highly skilled personnel raises the salary base. In a competitive market, failing to obtain such software can be the equivalent of surrendering market share to the competition. Clients that do not receive timely approvals and updates have the freedom to take their borrowing needs elsewhere. NGOs that are unable to verify what the MFI is doing because of poor reporting may cut off funding.

The introduction of smartcards, a credit card with an embedded microprocessor, represents an effort to both facilitate customer service and streamline record keeping. Loan officers can update accounts in the field when visiting clients through smartcard readers and either directly transmit transactions to a central computer or gather data to be efficiently and accurately entered into the system at a later time. Individual loan officers can attend to more clients and provide information to them more quickly. Using this technology involves additional costs but differentiates an MFI from its competitors. Palm pilots are also being used in the field to electronically process loan applications and in some cases provide applicants with virtually instantaneous approval through programmed credit scoring and a series of pertinent questions. While these innovations are not currently widespread, their availability and potential to have a major competitive impact makes their introduction more likely.

Field staff compensation accounts for 50% to 70% of administrative costs (Gibbons and Meehan, 2000). A minimum target clientele for each loan officer is 300 borrowers. Both
smartcards and palm pilots increase the efficiency of loan officers and can reduce administrative costs. Achieving a positive return on the sizeable initial investment required to introduce these technologies necessitates a large client base and a requisite level of sophistication of employees. Larger MFIs already having achieved some economies of scale and sufficient funding to invest in more sophisticated technology will pressure competitors to do the same even as they find it necessary to continuously upgrade.

Collecting and maintaining records electronically can improve the accuracy of record keeping, but without the ability to compare overall aggregated institutional performance with other MFIs an individual MFI is less aware of areas in need of improvement. Ideally an MFI should be able to compare its performance not only with other MFIs but with acknowledged leaders. In the developed world continuous improvement is closely linked with benchmarking performance to those companies or institutions identified as the best. Industry or institutional leaders that have adopted the best practices and achieved superior performance make that performance public. Institutions that fall short of the best know that their performance will be compared to leaders in the industry. The microfinance industry is beginning to establish benchmark comparisons—industry levels that all MFIs should strive to attain.

**Benchmark Ratios**

Inter-American Development Bank (IDB) and MicroRate solicited and obtained financial information from 17 MFIs in Latin America to compile benchmark financial ratios for the Latin American area. Of these 17, 9 were regulated institutions and 8 were not. The MFIs ranged from BancoSol in Bolivia with nearly $75 million in outstanding loans to FINCA in Nicaragua with a $935,000 loan portfolio (Jansson and Taborga, 2000). Table 1 shows the results of the survey, including IDB/MicroRate recommended benchmarks gleaned from
<table>
<thead>
<tr>
<th>MFI Benchmark</th>
<th>Nonregulated MFIs (8)</th>
<th>Regulated MFIs (9)</th>
<th>Commercial Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA (adjusted)</td>
<td>2-5%</td>
<td>0.80%</td>
<td>0.20%</td>
</tr>
<tr>
<td>ROA (unadjusted)</td>
<td>4-8%</td>
<td>12.10%</td>
<td>3%</td>
</tr>
<tr>
<td>ROA (adjusted)</td>
<td>10-15%</td>
<td>-3.90%</td>
<td>n/a</td>
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<tr>
<td>ROA (unadjusted)</td>
<td>20-30%</td>
<td>19.90%</td>
<td>6.90%</td>
</tr>
<tr>
<td>Gross Fin'l Margin (adjusted)</td>
<td>20-30%</td>
<td>21.50%</td>
<td>n/a</td>
</tr>
<tr>
<td>Gross Fin'l Margin (unadjusted)</td>
<td>25-35%</td>
<td>20.10%</td>
<td>5.50%</td>
</tr>
<tr>
<td>Debt/Equity</td>
<td>3:1 to 8:1</td>
<td>0.9:1</td>
<td>5:3:1</td>
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<tr>
<td>Equity/Gross Portfolio</td>
<td>25-35%</td>
<td>86%</td>
<td>23.70%</td>
</tr>
<tr>
<td>Portfolio at Risk (&gt;30 overdue)</td>
<td>1-3%</td>
<td>4.70%</td>
<td>4.40%</td>
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<tr>
<td>Loan Loss Reserves/Loans &gt;30 days overdue</td>
<td>75-125%</td>
<td>104.30%</td>
<td>163.40%</td>
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<tr>
<td>Write-offs/Avg Gross Portfolio</td>
<td>&lt;2%</td>
<td>0.60%</td>
<td>0.30%</td>
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<tr>
<td>Cash &amp; Marketable Securities/Total Assets</td>
<td>10-25%</td>
<td>18.30%</td>
<td>14.50%</td>
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<tr>
<td>Gross Loan Portfolio/Total Assets</td>
<td>70-90%</td>
<td>75.50%</td>
<td>80.30%</td>
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<tr>
<td>Loans per Credit Officer</td>
<td>&gt;300</td>
<td>280</td>
<td>608</td>
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<tr>
<td>Gross Portfolio per Credit Officer</td>
<td>$200,000-$400,000</td>
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<td>Optg Expenses/Average Assets</td>
<td>&gt;15%</td>
<td>28.10%</td>
<td>15.20%</td>
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<tr>
<td>Optg Expenses/Average Gross Loan Portfolio</td>
<td>&gt;20%</td>
<td>38.90%</td>
<td>19.80%</td>
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<tr>
<td>Optg Expenses/Average Number of Loans</td>
<td>&gt;$125</td>
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<td>$157</td>
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<tr>
<td>Growth of Total Assets</td>
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<td>17.90%</td>
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<tr>
<td>Growth of Gross Portfolio</td>
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<td>Growth of Equity</td>
<td>20-40%</td>
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<tr>
<td>Average Loan Size</td>
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<td>$957</td>
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</table>

* (>90 days)
the best performers among the 17 institutions, performance on
the same ratios obtained from the nine regulated MFIs and the
eight nonregulated MFIs, and ratios of commercial banks from
Latin America and the Caribbean. Adjustments were made to
audited data to account for differences between countries.
Gross financial margin, return on assets (ROA), and return on
equity (ROE) are ratios subject to distortion because of sources
of funding, i.e., outright grants or subsidized loans. A separate
calculation is provided that adjusts data used to compile these
ratios by removing subsidies. Target benchmarks were also cal-
culated based upon the measures of the better performing MFIs
in the group of 17.

Unadjusted return on assets (ROA) and return on equity
(ROE) for the MFIs are considerably greater than adjusted
measures, reflecting that on average these MFIs still receive
substantial subsidies. Removal of the subsidies to produce
adjusted data shows borderline financial sustainability. The
averages are also below benchmarks set by the better perform-
ing cohort. Individual MFI goals may vary but since nine of
these MFIs are already regulated and many of the remaining
eight aspire to become regulated entities, performance levels
approaching the MFI benchmarks are more appropriate to
both attaining and maintaining regulated status. MFIs that are
borderline performers are likely to be judged as more risky by
any institution or NGO providing funding, which can either
result in denial of funding or the imposition of higher interest
rates on that funding.

Gross financial margin, returns on assets exclusive of non-
financial operating expenses, needs to be high since MFIs typi-
cally have high operating expenses that need to be covered with
those returns. Charging high interest and maintaining near per-
fect collection policies can be key to surviving. Both adjusted
and unadjusted gross financial margins are high for the MFIs
and well above that obtained by the commercial banks. The
ability of commercial banks to succeed with lower gross finan-
cial margins may be due to the economies of scale possible at
larger institutions. Greater utilization of technology could lower nonfinancial operating costs and enable MFIs to lower interest rates on loans. There would still be the greater risk involved in making loans that are not collateralized to less educated borrowers in need of greater servicing. This would still entail the maintenance of higher gross financial margins than commercial banks.

Commercial banks do show their economies of scale by widely outperforming MFIs on operating expenses as a percentage of assets. Regulated MFIs in turn achieve economies of scale superior to unregulated MFIs as shown by their operating expenses to assets ratio of 15.2% vs. 28.1% for nonregulated institutions and operating expenses to total loan portfolio of 19.8% vs. 38.9%. Regulated MFIs incur greater operating expenses per loan, $157 vs. $87 for nonregulated institutions, but again this is overshadowed by the $957 average loan vs. $356 for nonregulated MFIs.

The debt-to-equity ratio of nonregulated MFIs is below 1.0, indicating either an inability or a reluctance to use leverage to finance operations and expand loan portfolios. Regulated MFIs have an average D/E ratio half as great as the commercial banks. Access to capital markets is certainly an issue for MFIs. Regulated MFIs with better reporting and the security of government oversight would have better access to capital markets for funding but may pay higher rates than commercial banks. Nonregulated MFIs would depend more on NGO financing, often subsidized and outright equity, which is why their D/E ratio is so low. Equity as a percentage of gross portfolio is also quite high for nonregulated MFIs, again reflecting predominately equity sources of financing and thereby constraining potential growth. Regulated MFIs are quite close to commercial banks on this measure.

Portfolio at risk (PAR) is comparable between both groups of MFIs, averaging over 4% in both cases, and above the high range of the recommended benchmark of 3%. Commercial banks at 1.16% are performing comparably even better than
this low ratio indicates because their PAR represents loans overdue by 90 days vs. 30 days for MFIs. Different reporting standards on PAR can make comparisons difficult. One version of this ratio is calculated as (gross loans outstanding overdue more than 30 days)/(total loan portfolio). This measure does not take into account distortions that arise from including new loans that have not been outstanding for over 30 days in the denominator, thus biasing this ratio downward to a performance better than might actually be occurring. The downward bias can be more substantial in newer MFIs with more rapidly growing portfolios and larger proportions of their portfolios loaned out in the past 30 days. Using an adjusted ratio calculated as (gross loans outstanding overdue more than 30 days)/(total loan portfolio outstanding more than 30 days) provides a clearer picture of portfolio performance (Rosenberg, 1999). Standardizing reporting of PAR to this measure would enhance comparability.

Nonregulated MFIs have lower loan loss reserves than regulated MFIs and commercial banks, though still within the recommended benchmark. The use of an aging schedule to arrive at loan loss reserves, i.e., weighting overdue loans by the probability of collection multiplied by days outstanding, can vary across institutions. Regulated institutions would be required to adhere to more standardized guidelines. Nonregulated MFIs are also motivated and able to dress up their income statements by minimizing loan loss reserves in order to continue to have access to NGO capital.

Timing is everything when it comes to calculating write-offs as a percentage of a portfolio outstanding. Some institutions may prefer to carry nonperforming loans on the books, viewing write-offs as negative performance indicators. This tactic instead creates higher PAR, a negative indicator. MFIs in the survey were all below the 2% benchmark. Both regulated and unregulated MFIs were surprisingly low: 0.30% and 0.60% respectively. The practice of refinancing nonperforming loans to avoid writing them off could also be a factor.
Financial Performance

Liquidity as measured by cash and marketable securities as a percentage of total assets should not be above or below the benchmark performance band of 10% to 25%. Too much liquidity means assets are not being loaned out, and too little places the institution in danger of failing to meet pending obligations. Commercial banks are the most conservative of the three groups, with liquidity above the levels recommended for MFIs. One explanation for this is that commercial banks have demand deposits, which are somewhat unpredictable obligations necessitating greater liquidity. Deposits are typically missing from the asset mix of most MFIs. Commercial banks are also more conservative in lending out their assets that is reflected in the 48.5% gross loans to total assets, percentage, much below that of the MFIs. Again, this is likely a function of the need to service depositors as well as more investments in fixed assets such as buildings.

There is a large distinction in operating performance as measured by loans serviced per credit officer. Nonregulated MFIs are just below the benchmark of 300 while regulated MFI credit officers serviced 608 loans in 1998. Superior efficiency of regulated MFIs may be in part due to multiple loans to the same borrower as well as better technology support. Gross loans per credit officer are also considerably greater for regulated MFIs ($220,000) as compared to nonregulated MFIs ($91,000), that is partially explained by more loans per officer but also amplified by the smaller average nonregulated MFI loan of $356 vs. the regulated MFI average of $957.

Nonregulated institutions with lower base figures against which to measure growth exceed regulated MFIs in both growth in assets, growth in portfolio, and growth in equity. Interestingly, commercial banks also exceed regulated MFIs on all three measures and are roughly equivalent to nonregulated MFIs on all three indicators. With a larger base from which to grow, a superior growth rate may reflect the ability of commercial banks to better participate in an overall economic
expansion by loaning directly to larger businesses or the government.

This is a small sample of MFIs from Latin America. The MicroBanking Bulletin has a larger global sample, but unlike the study presented by IDB and MicoRate, there is no attempt to define benchmarks but rather averages. These are also informative except for the fact that here too there is a dearth of data on individual institutions, just 23 from all countries versus the IDB and MicroRate study of 17 just from Latin America. It is a start to bringing some comparability to a fledgling industry making a transition from charitable recipients to real businesses. In order for the transition to continue and to succeed, more data with which to make comparisons is needed. Likewise, it will be necessary to devise some across-the-board measures that report the degree to which social mission is accomplished. Without these additional measures, differentiating MFIs from commercial banks on any measure other than financial is a difficult task.

Establishing benchmark financial performance targets is a viable goal. MFI reporting of data is essential for the analysis, understanding, and dissemination of practical suggestions on how to attain those benchmarks. Databases representing different kinds of institutions from diverse geographic areas will enable the creation of different benchmarks applicable to varying situations. Social performance can be taken into account in comparing benchmarks if and only if standardized measures are employed and reported across institutions. It will be to all participants’ benefit and even more so to the benefit of potential clients to systematize reporting and make data public.

Conclusion

Comparisons with benchmarks can alert management and those that fund MFIs to how well or poorly an MFI is performing. By revealing weaknesses, benchmark measures can be used as a guide to focus resources and upgrade management practices. The best MFIs achieve superior performance by
employing superior business practices. MFIs at the lower end of the performance scale may have management less familiar with superior or even standard business practices, such as using management information systems to the greatest advantage, projecting future cash flows, and planning. These basic practices done well are certainly requirements of a high performing MFI.

To reach a level of operational excellence required to become a financially self-sufficient MFI requires well-trained, honest, and motivated management. But personnel skilled in business may be difficult to attract and retain in a developing country where such skills are in short supply and are well rewarded in the profit sector of the economy. This is a dilemma that can only partially be remedied by finding people sufficiently dedicated to be willing to reject higher compensation because of a dedication to serving the poor.

Becoming a regulated institution with concomitant access to capital markets is the goal of many unregulated MFIs. Meeting regulatory requirements entails reaching financial self-sufficiency. Achieving profitability may mean increasing the size of loans in order to focus more on profits. Service to the poorest that borrow small sums at considerable expense to an MFI may decline. In the IDB study Latin America’s regulated MFIs had much higher average loans than those that were not regulated.

The initial vision of Grameen to provide the poorest an entry point into the economy with loans instead of handouts has inspired the creation of thousands of MFIs worldwide. Instead of the initial poor clients eventually taking their business to banks as they prospered, Grameen and other MFIs have found that becoming banks or quasi-banks is an effective strategy for retaining clientele and reaching financial self-sufficiency. The MFIs not making the transition face the more daunting task of surviving while serving the remaining poorest who may not in the aggregate be able to use loaned funds as effectively and efficiently as previous borrowers. These MFIs
that are less likely to attain financial sustainability need to develop a standardized set of benchmarks that demonstrate their attainment of their mission of servicing the poorest of the poor. Measures derived from social audits would be the most likely source of such benchmarks.

Competition among MFIs will inevitably lead to failures, possibly consolidation, and also service concentrating on specialized market niches such as the more difficult niche of the poorest of the poor. Donors and investors will need to carefully examine their own goals and differentiate among the available MFIs, particularly when deciding on subsidies or outright grants. Comparisons with benchmarks will be useful for all MFIs. A different way of sorting out the MFIs by mission rather than region and size alone may be necessary for those providing funding to make the most appropriate decisions.

Transparency and availability of quality data is crucial to making informed decisions. The thousands of MFIs that report only to those that provide funding make the trickle of publicly available data less representative. Those failing to report publicly are probably the least efficient. When they do seek funding and present their performance figures to NGOs they may end up being compared with the more efficient reporting MFIs, making it increasingly difficult for them to obtain funding. Perhaps this is just another way that an ongoing process of eliminating the weakest performers will move forward.
Financial Performance

References


Microcredit and the Rural Poor

A Review of the Maharashtra Rural Credit Project

by Raghav Gaiha

Abstract: An attempt is made to review the Maharashtra Rural Credit Project (MRCP)—a microcredit scheme—by focusing on the process of implementation and its implications for targeting, empowerment of women, and trade-off between coverage of the poorest and sustainability of this scheme. Attention is drawn to deficiencies in the design and implementation of this scheme that limit the participation of the poorest and the benefits accruing to them. Moreover, it is argued that there is a risk of overstating the trade-off between the coverage of the poorest and sustainability of the MRCP if these deficiencies are overlooked.

Introduction

The Maharashtra Rural Credit Project (MRCP), funded by International Fund for Agricultural Development (IFAD), among others, was launched in 1994. Since its inception, it has made substantial progress (UNOPS, 1997, 1998; IFAD, 1997, 1999). The present study is a selective review of the process of implementation of this project, focusing on the targeting of the poorest, women’s control over the assets acquired, and trade-offs between coverage of the poorest and sustainability of this project. Although aspects of the impact of the MRCP
are considered, these are not central to the analysis. The analysis is based on interviews of agencies involved in its implementation and a small sample of households in three villages in Pune District (Maharashtra). Although it is risky to generalize from a small survey—especially in view of the variation in the performance of the MRCP in different districts—some useful insights into its functioning are obtained.

According to a recent estimate, barely 20% of the rural poor and 10% of the poor women had access to institutional credit (IFAD, 1999). Unavoidably, they continue to depend largely on the informal sector (e.g., money lenders, traders, friends, and relatives). Apart from high interest rates—ranging from 5–10% per month—usually informal credit sources do not cater to productive needs. There is thus a large unmet demand for credit among the rural poor. Also, there is demand for savings and insurance services. Savings are valued as they enhance family security—provide insurance during periods of stress, a source of consumption smoothing, and margin money for asset purchase loans. Various forms of insurance—life insurance, health insurance, and crop insurance—are desired for providing protection against contingencies (e.g., accidents, illness, drought).

The MRCP

Rationale
It was against this background of a large unmet demand for microfinance services that the MRCP was designed. More specifically, the purpose was to “develop and test through field implementation, an alternative approach to the Integrated Rural Development Program (IRDP) that could efficiently provide improved financial services to the rural poor.” If successful, the approach could be “incorporated into the large IRDP program, thereby not only improving its efficiency but also its

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targeting of the deserving poor” (IFAD, 1997, p. 2). The wide-ranging financial and economic reforms initiated in mid-1991 reinforced this concern. An apprehension was that the emphasis on efficiency and profitability could force closing down unprofitable bank branches, thereby further reducing the access of the rural poor. The MRCP aims to demonstrate that a sustainable improvement in the delivery of financial services to the rural poor is feasible.

Objectives
Broadly, the MRCP was designed to (1) improve access of the rural poor to financial services, (2) to make them bankable clients, and (3) promote savings mobilization among them through self-help groups (SHGs).

Scale
The project with an outlay of US$48.35 million is supported by an IFAD loan of US$29.20 million. The contribution of the government of India (GOI) and the government of Maharashtra (GOM) is US$14.97 million and of the participating banks is US$1.65 million. The projected co-finance of US$2.5 million has not yet materialized. The loan agreement was approved on 1 June 1993 and became effective on 6 January 1994 (UNOPS, 1998).

In the initial phase, the project covered four districts (Pune, Chandrapur, Yavatmal, and Nanded). Following the Mid-Term Review and Evaluation in October 1997, seven more districts were added (Thane, Dhule, Jalgaon, Amravati, Bhandara, Gadchirali, and Beed). With the proposed expansion (in phase II), the project benefits are expected to cover 91,250 borrowers including 54,300 members of SHGs (UNOPS, 1998).

Salient Features
The target group consists of households below the poverty line (i.e., with annual household income up to Rs.11000 at 1991-92 prices). Priority is given to those with incomes up to Rs.8,500.
This subset comprises mostly small/marginal farmers, landless, artisians, and tribals.

In order to make the MRCP truly participatory, a village development assembly (VDA) comprising all households in a village is formed. This serves as a forum for a preliminary dialogue on the problems, prospects, and process of development. Out of the VDA, a village development council (VDC)—comprising 10–12 members—is constituted. The VDA prepares a people's action plan (PAP), focusing broadly on social development of the village—especially credit requirements and support systems. The VDC is responsible for its implementation.

Two channels of credit are used: individuals and SHGs. Using the list of poor households, eligible (individual) beneficiaries are identified in a meeting of the VDC, attended by the members of the council and representatives of the NGO, the CB (commercial or participating banks) and other implementing agencies. SHGs, on the other hand, are formed either by Mahila Arthik Vikas Mahamandal (MAVIM) directly through its sahyoginis (SYGs)/field workers or through NGOs contracted by it or by the banks directly or through NGOs contracted by them. Both individual and group borrowers are charged an interest rate of 12% per annum. Individual borrowers are given loans for specific activities. SHGs, on the other hand, are required to mobilize savings first. After achieving some financial discipline, SHGs are allowed to borrow against their savings deposits from a CB. The loans are distributed among the members in accordance with their own priorities/rules (about loan use, amount, interest rate, repayment, and penalty). The rate of interest is typically 2–3% per month. Consumption loans are permitted. Eventually, when the credit worthiness of SHGs is established, it is expected that they will be able to borrow independently from CBs.

Coordination committees were set up at the national, state, and district levels. A task force coordinates at the block level. VDAs/VDCs, assisted by village level workers, do so at the village level.
Considerable importance is attached to information about investment opportunities, skill formation, and technical advice. Several agencies (MAVIM, Maharashtra Industrial and Technical Consultancy Organization [MITCON] and Maharashtra Centre for Entrepreneurship Development [MCED]) provide these services to the borrowers. Moreover, members of VDCs are trained to perform their functions efficiently, as also are the sahyoginis. Bank staff, on the other hand, are trained to deal more sympathetically with poor borrowers with limited financial skills and training. Some major deficiencies of the IRDP are avoided, as the poor borrowers are better equipped to use the loans productively and the implementing agencies (e.g., CBs) are more sensitive to their special needs. Under the MRCP, while CBs lend at 12% per annum, the average cost of funds for them is 9–10%. As this spread does not cover their costs, NABARD provides full refinance at 6%.

**Issues**

Earlier review points to the rapid expansion of the MRCP. However, attention is also drawn to a few weaknesses. Firstly, there is some concern that the targeting has been unsatisfactory. As of March 1997, out of the 11,000 members of SHGs, about 32% were nonpoor, or not below the poverty line (non-BPL). Out of the four districts in phase 1, Yavatmal had the best record in this respect, with about 82% of the members classified as BPL. Given the data constraints and credit delivery system, it is suggested that a share of about one third of non-poor beneficiaries is about right (UNOPS, 1998). But this view is contestable on several grounds. One difficulty is of course the unreliability of the list of BPL households. Often it includes 80–90% of all households in a village. But more seriously, excessive coverage of non-BPL households in some areas is largely a consequence of inactive VDCs or their manipulation by locally influential persons. Secondly, although SHGs have been instrumental in channeling credit to poor rural women and in imparting self-confidence to them, there is some
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corncern that linkage to the banks has been slow. The reasons include cumbersome procedures (e.g., elaborate documentation), relative unimportance of MRCP loans in the banks’ portfolios, and lack of incentives to field officers (FOs). Finally, despite the emphasis on market intelligence, skill formation and technical assistance, the promotion of off-farm activities has been unimpressive. Evidently, the information and training provided warrant some reorientation. For example, it is not obvious how useful Entrepreneurship Development Programs (EPDs) are for poor rural women without any exposure to markets.

Given this overview, a selective review of the MRCP was undertaken for a deeper understanding of its functioning. The review focuses on the following issues.

1. One is whether there is scope for better targeting on the poor. In particular, an issue is whether the exclusion of the poorest is deliberate (i.e., due to the bias of the implementing agencies, e.g., banks).

2. Another major concern is whether women have any control over assets and incomes accruing from them, as it has important implications for household welfare. In male dominated communities, there is a danger that women may be used as conduits for obtaining loans. In fact, there is some evidence that repayment difficulties resulted in violence against women in Bangladesh (Rahman, 1998). An issue is whether there are some assets or activities that allow women greater flexibility in combining them with household chores.

3. Since the MRCP was designed to demonstrate the superiority of an alternative approach to that of the IRDP, an issue is whether closer involvement of the community in the MRCP makes a difference.

Given the objective of this study and the sample design, precise inferences about these aspects cannot be drawn. Rather, the focus will be on some broad outcomes and the underlying processes.
Microcredit and the Rural Poor

Methodology
Considering that the focus of the present study is on the process of implementation of the MRCP, it was decided to conduct detailed interviews of representatives of implementing agencies and a few participating and nonparticipating households (constituting the control group). The interviews were based on structured questionnaires. Thus a composite account of the functioning of this project is obtained.

Sample Design

Villages
Pune District was chosen largely because of its diversified rural economy. Given the time and budget constraints, three villages (Kanhewadi, Mohkal, and Kaman) were chosen. As described below, these villages reflect wide variation in socioeconomic conditions.

Apart from variation in opportunities for gainful employment in agriculture (associated with variation in irrigated area), the composition of the village population—particularly the share of the poorest groups—also varies considerably. Kanhewadi has the highest share of scheduled caste/scheduled tribe (SC/ST) population (48.60%), followed by Mohkal (19.60%) and Kaman (15.78%). The occupational distribution of workers also differs. Considering the shares of cultivators and agricultural labourers, Kanhewadi’s shares are 61.50% and 26.10%, Mohkal’s 78.06% and 18.50%, and Kaman’s 74.90% and 13.30%.

Households
Although the sample was purposive, some attention was given to its representativeness with a view to better understanding the exclusion of the poorest and inclusion of nontarget groups and the diversity of experiences of the beneficiaries. This is done through a random selection of households from broadly specified groups. Although a small sample of 30 households did
not allow much flexibility, some broad considerations consistent with the objectives of this study are noted below.

**Individual Beneficiaries**

Fifteen individual beneficiaries were interviewed. Ten of these were supposed to be poor. However, using some broad correlates of poverty (i.e., whether the beneficiary belonged to a SC/ST, agricultural labour, or smallholder household), the actual count of poor in the sample turned out to be seven, and of the relatively affluent, eight.

**Control Group**

Seven nonparticipating households were interviewed, belonging to SC/ST, agricultural labour, and smallholder groups.

**SHGs**

Women belonging to five SHGs with a satisfactory track record of savings mobilisation and bank loans were interviewed. Out of these, four belonged to SC/ST, agricultural labour, or smallholder households, while one belonged to a relatively affluent household.

**Control Group**

The control group comprises SHGs that were not linked to a bank. Three women representing such SHGs were interviewed. All three belonged to SC/ST households.

**Implementing Agencies**

A few individuals representing official agencies (NABARD, DRDA, DPCC, MAVIM, MCED, and MITCON), participating banks (State Bank of India [SBI], Bank of Maharashtra [BOM]), an NGO (Chaitanya), local community organizations (VDAs/VDCs), and field-workers (Sahyoginis) were interviewed.
Targeting of MRCP

Two aspects of targeting are considered below: one is participation of the poor in the MRCP and the other is the benefits accruing to them.

Individual Beneficiaries

The sample consisted of fifteen individual beneficiaries, four from Kanhevadi, three from Mohkal, and eight from Kaman. Although it was intended to have a larger number of poor participants than nonpoor participants, the latter turned out to be larger. As the number of poor participants is seven, less than 50% are poor. Among the poor, three are extremely poor (i.e., their household incomes were Rs. 2500 per annum). There are two widows: one owns 0.50 acre of land and the other is landless. Among the poor beneficiaries (as also in the complete sample), the single largest occupational group is agricultural labourers (i.e., 6).

Even after making an allowance for the difficulties of excluding non-BPL households altogether, their overrepresentation among the beneficiaries is indisputable. Among them, one beneficiary owned 20 acres and another 12 acres. As these beneficiaries would be generally deemed affluent, it is likely that their inclusion was manipulated.

SHGs (or Group Beneficiaries)

Although the number of SHGs in the sample is small (five), it is significant that four representatives are poor (all women). Out of the poor, two belong to SC/ST households. Three of the poor representatives own small quantities of land (ranging from 0.5 acre to 1.75 acres). The main sources of income are cultivation and agricultural labour. The only affluent representative (from Mohkal) owns 8 acres of land and belongs to an upper caste household. Her main source of income is cultivation. Considering the composition of SHGs, it is a fair presumption that the share of poor participants is higher among the SHGs than among the individual beneficiaries. As the loan amounts are small and their use is unrestricted (in other words,
consumption loans are allowed), self-selection of the poor is an important contributory factor. To the extent that NGOs are involved in awareness building among the deprived groups, the self-selection process is strengthened.

**Loan Amount**

Confining to *individual* beneficiaries, a notable difference between the poor and the nonpoor is that the latter secured much larger loans. Their loans ranged from Rs.10,000 to Rs.25,000 while those of the poor ranged from Rs.5,000 to Rs.11,000. Although this is undoubtedly partly a result of the difference in their absorptive capacities for loans, it cannot be ruled out that larger loans to the relatively affluent also reflect their influence with the implementing agencies (VDCs and banks).

**Uses**

Although detailed data on loan use could not be obtained, some differences are indicated. The nonpoor use their loans in more diverse ways than the poor. Specifically, they use their loans for buying livestock, digging wells, trading in fruit and vegetables, and fishing. The poor, on the other hand, use their loans for buying livestock, goats, and fishing nets. More importantly, except for two nonpoor beneficiaries, the remaining earned surpluses over and above the loan dues. On the other hand, while the poor earned enough to repay the dues, two experienced difficulties—one because of seasonally low yields (in fishing) and another because of a contingency (illness).

To sum up, among the individual borrowers, the number of relatively affluent was nonnegligible. More seriously, even their benefits were substantially larger.

**Self-Help Groups (SHGS)**

As SHGs are an innovative feature of the MRCP, their functioning and impact are reviewed in detail. The five successful cases are reviewed first.
Functioning

As noted earlier, except for one, all representatives belonged to poor households (including SC/ST households). Given the group homogeneity, it follows that the share of the poor was higher among SHGs than among individual beneficiaries. The self-selection of the poor in SHGs owed much to the efforts of Grameen Mahila Swayam Sevak Sangh (a women’s group) and Chaitanya (an NGO). Moreover, as a result of training received, their awareness of how the scheme operated was much better.

Usually, a group leader is elected to conduct the meetings of the SHG. The size of the meeting varies from 15–20 persons. The meetings are held once a month on a fixed date. The agenda are announced in advance. Items include minutes of the previous meeting, disbursement of loans, collection of savings, fines, and other related matters. Records of loans and savings are maintained by a member of the SHG or the group leader. These are verified by a representative of Chaitanya and are sometimes audited by an external agency. The members are fully aware of the entry and exit rules. A new member, for example, has to pay all dues. Members are discouraged to leave before five years. When a member leaves, all her savings with interest are returned.

The time taken for borrowing from a bank varies with the SHG. Usually, the minimum period is 1–3 years. Savings mobilisation through small weekly or monthly installments is impressive. The monthly savings of the SHG in Mohkal, for example, are Rs.2000 and the total (accumulated savings inclusive of interest) Rs.1,10,000. Savings are deposited in a bank (in a savings account) against which a loan is obtained. Usually, the ratio of credit to savings is 2:1, although it is allowed to vary from 1:1 to 4:1 (Karmakar, 1999). The average amount borrowed by an SHG ranges from Rs.20,000 to Rs.25,000. Loans are given to members in accordance with the priorities of the SHG at an interest rate of 2–3% per month. The rate of interest is slightly lower for productive purposes than for con-
sumption. Use of the loan is decided by the member. It is repaid in monthly installments over a year. Even though the interest rate is much higher than that charged by banks, some members prefer it to direct borrowing from banks because of the ease of borrowing (i.e., simpler and quicker procedures). No defaulters among the members were reported, confirming a high degree of financial discipline. Equally, from the point of view of the banks, based on the experience of bank managers interviewed, the recovery rate is impressive (well over 90%).

Impact
Although detailed data on loan use and yields were not collected, the fact that there were virtually no defaulters suggests that repayment at high rates of interest was not a problem for poor borrowers. However, it is a moot point whether there are more than a few activities—especially in the nonfarm sector—which would yield returns in excess of 24–36%. In that case, the range of viable investment options would be limited. Also, as the loans are relatively small (compared with individual loans under the MRCP), the options would be further restricted. But the gains to the poor in terms of easier access to credit and financial discipline must not be underestimated. Moreover, as elaborated later, despite the control exercised by male members in the choice and use of the assets, there is some evidence—by no means conclusive—suggesting that the status of women both within and outside the household has improved. The benefits to the poor rural women—many of whom might not have had access to formal credit channels—through SHGs may thus be substantial. But whether the costs are high too is not implausible. Although it takes six months to form an SHG and 1–3 years for it to borrow from a bank, much depends on the initiative of NGOs and banks. The potential for reducing the costs may thus be substantial.
Exclusion of the Poorest

Exclusion of the poorest from microcredit schemes is well known. However, the reasons for their exclusion remain uninvestigated. Indeed, there is often a presumption that the moderately poor are less likely to default than the acutely poor. In that case, targeting the moderately poor is likely to be more sustainable financially. So exclusion of the poorest may well be connected with a concern for financial sustainability. The present study explores the reasons for the exclusion of the poorest in the sample villages.

Lack of Awareness

Few among the control group for individual beneficiaries—mostly very poor households—knew anything about the MRCP. There were two (out of the seven) who seemed vaguely aware of this scheme through information disseminated by the VDC and bank officers. The lack of awareness among two tribal women (out of the three) in the control group for group beneficiaries was equally glaring. Although more than a few poor beneficiaries—especially individual borrowers—were also not fully informed about some aspects of the MRCP (e.g., repayment obligations), they owed their participation either to their own initiative or to their previous experience in the IRDP. Among the group beneficiaries—mostly very poor—however, much of the credit for their participation goes to the initiative of Grameen Mahila Swayam Sevak Sangh and the support and training provided by Chaitanya. It is not implausible that the neglect of SHGs in the control group was related to their extreme poverty.

Social Exclusion

Although extreme poverty and social exclusion tend to go together, some insights into the latter acting as a barrier to participation in the MRCP are obtained from the responses of a few SC/ST households in the two control groups (i.e., one for individual beneficiaries and another for SHGs). Despite con-
siderable initiative, one SC/ST respondent in Kanhewadi lamented that he was not allowed to join an SHG. Another SC/ST respondent in the same village narrated a similar experience, pointing to the uncooperative attitude of the village community. A third tribal respondent in Kaman was apprehensive that his efforts to join an SHG might provoke a hostile reaction from village and local authorities. In contrast, the two tribal women belonging to the control group for group beneficiaries in Mohkal accepted their social exclusion passively.

Collusion
The inclusion of affluent households—with two owning 12 and 20 acres of land in Mohkal—reflects collusion among bank staff, Sarpanch/Gram Sevak, and VDC. In each of the three sample villages, most of the nonpoor households were nominated either by a Sarpanch or Gram Sevak and duly recommended by the VDC. The case of a vice chairman of the VDC in Kaman nominating himself for a loan without any objection from the VDC members or bank staff (who normally attend VDC meetings) or Panchayat members is a glaring example of collusion among them. The fact that all nonpoor beneficiaries belonged to upper castes may not be a mere coincidence, as their domination of local bodies is well known.

In contrast, SHGs represent the poor better in our sample, largely because of their self-selection, induced by small loans unrestricted in their use. This process of self-selection was aided considerably by the initiative and support of Grameen Mahila Swayam Sevak Sangh and Chaitanya.

But above all the identification procedure is unsatisfactory. Even though it is well known that the list of poor households is faulty—often 80–90% of the households in a village are classified as poor—that is the only basis for identifying the eligible households. What is worse, the list is maintained by the Gram Sevak, giving him undue importance in the selection process. Instead of the BPL list being in the public domain—it is meant to be displayed in the Village Panchayat office or some other
prominent place—it is usually the Gram Sevak’s declaration that counts.

**Loan Appraisal and Follow up**

The poorest—especially from SC/ST households—faced difficulties not just in the selection process but also in their bank transactions. The documentation was expensive and time consuming. These difficulties were compounded by their illiteracy, their lack of familiarity with the procedures, and the unhelpful attitude of the bank staff. As a result, the processing of loan requests of the poor took much longer (1–6 months, as against 1–2 months in case of the nonpoor).

In general, bank staff gave hardly any loan related advice. In fact, unless the applicant took the initiative, repayment obligations were seldom fully disclosed. Nor was there any follow-up of loan use. As the poorest would have benefited more from such advice and follow-up (e.g., in terms of productive use of assets), its absence had serious implications for them.

**Financial Stringency**

Too much financial discipline or stringency—strict repayment requirements, penalties for delays, etc.—could deter the poor from joining a microcredit scheme or could limit duration of their participation in it (Montgomery, 1996). These effects are present in our sample but in a somewhat weak form. Among individual beneficiaries, one SC/ST respondent reported that he defaulted once and therefore had to pay two installments together. Two other respondents drew attention to the seasonal variability of income from fishing constraining their repayment ability. Apart from social exclusion, one nonparticipant SC/ST respondent (from the control group for individual beneficiaries) was skeptical of joining an SHG because of his seasonal employment. A (tribal) widow, who belonged to the control group for group beneficiaries, was equally diffident about borrowing under the MRCP because of the irregularity of her income. None of the participants, however, dropped out of the scheme.
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These responses point to the need for flexibility in the repayment of individual loans from banks (with monthly or quarterly or annual installments over a period of 2–5 years) as well as in loans given by SHGs (with monthly installments over a period of 1 year), with a view to enhancing the participation of the poorest—many of whom are subject to uncertain or (seasonally) fluctuating incomes.

Surprisingly, even though loans from SHGs were costlier (2–3% per month as against 12% per annum from a bank), some members—including the poorest—were emphatic that the ease of obtaining loans and flexibility in their use more than compensated for the higher cost. However, some poor individual beneficiaries would prefer membership in SHGs provided the loan amounts are larger and interest rates lower.

To sum up, while some of the poorest failed to participate in the MRCP either because of their lack of awareness or inability to overcome their social exclusion, many more were excluded because of arbitrariness in the selection of beneficiaries by VDCs and inadequate flexibility in the design of the scheme (more specifically, in repayment requirements). To the extent that the default rate is negligible and SHGs better represent the poor, further extension of the coverage of the MRCP mainly through SHGs may well be sustainable provided of course the special needs of some backward sections (e.g., tribal groups) stemming from their social exclusion and irregularity of income are systematically addressed.

Community Involvement

In principle, VDAs/VDCs have an important role in identifying beneficiaries, arranging for loans, and following up on the loans. Their formation, representativeness, and functioning are thus crucial to the targeting of the MRCP. However, the picture that emerges from our survey of three villages in Pune District is far from reassuring.
Formation
The VDCs were constituted by the participating banks somewhat hastily and in an ad hoc manner to launch the MRCP. Locally influential persons or groups, along with a few SC/ST representatives, were inducted. A few Panchayat members—including the Sarpanch—were also included. The relationship between the VDAs and VDCs is somewhat vague. Although bank officers and NGOs are supposed to participate in the VDC meetings, their participation is usually a ritual.

Representativeness
Since there are no elections and the bank usually nominates SC/ST and other members, the VDC is not a representative body. Moreover, the nominated SC/ST members are unaware of the objectives, procedures, and decisions. One woman SC/ST member of the VDC (in Mohkal), for example, knew nothing about the MRCP. She did, however, assert that the VDC was dominated by influential persons.

Functioning
The VDC meets once a month. The agenda are not announced. The venue is a Gram Panchayat (village council) office or a temple. As there is no requirement for a quorum, the meeting is held even if there are more than a few absenteees. Selection of MRCP beneficiaries is seldom discussed. Either the Sarpanch (chairperson of the village council) or the Gram Sevak (the village level worker) nominates the beneficiaries. The list of poor households (i.e., those below the poverty line) is in the custody of the Gram Sevak. Although the lists are faulty (sometimes 80–90% of the households in a village are included), no questions are asked about their reliability. Even self-nomination of influential persons (a vice-president of a VDC, for example, nominated himself) is seldom challenged. If the poorest get included in the list of potential beneficiaries, it is either through the initiative of NGOs and Sahyoginis or through their own efforts. Attention is also drawn to the nexus between bank staff and VDC, resulting in substantially higher
loans to relatively affluent persons. The minutes (including the list of beneficiaries) are usually in the custody of the chairperson or the secretary of the VDC. That exclusion of the poorest was to some extent deliberate cannot, therefore, be ruled out.

To sum up, the functioning of the VDCs was neither participatory nor transparent. Given the weak accountability mechanisms, arbitrary selection of beneficiaries remained uncontested. An issue therefore is whether the replacement of VDC and VDA by Gram Panchayat and Gram Sabha (village assembly), respectively, would make a difference. Although “capture” of Panchayats by a few influential persons is not unusual, the fact that they are elected bodies with a statutory basis renders them more representative of and accountable to the village communities. As a result, exclusion of the poorest may be reduced (Gaiha, 2000, Gaiha, Kaushik, & Kulkarni, 2000).

**Loan Use Control and Related Issues**

A few recent studies (e.g., Goetz and Sen Gupta, 1996; and Rahman, 1998) have drawn attention to the difficulties of targeting credit on rural women. In particular, attention is drawn to women being used as a conduit for obtaining credit with hardly any role in the choice of assets and no control whatsoever on the incomes accruing from them. Yet the responsibility for the repayment of loans is often exclusively that of women. In fact, failure to repay loans sometimes results in violence against them in poor households. The current survey throws some light on these issues.

**Asset Selection and Use**

Out of the four women who responded in detail to questions concerning asset selection and use, a widow—an individual beneficiary—insisted that the asset (bullocks) was chosen by her. But later on she admitted that the actual transaction was done by her brother-in-law because he knew more about bul-
locks. The remaining respondents pointed out that the decision was either that of the entire family or that of husband and wife. Subsequently, however, it was revealed that a so-called joint decision of husband and wife was in fact dictated by the husband. Thus, except for the widow, all other women beneficiaries had a limited role in the selection of assets.

Except for one woman who bought goats, all other women bought bullocks. As bullocks are used primarily by men (e.g., for plowing and transportation), it is unlikely that the women had any control over the bullocks. But whether intrahousehold distribution of power was reinforced in favour of male members seems unlikely, going by the responses of a few women and other members of the village community.

None of the women beneficiaries complained that the assets purchased interfered with their household chores. If feeding of bullocks and goats is not exclusively a female responsibility or not a strenuous activity, it may not add much to a day’s work.

Income
In most cases—including a widow who bought goats and reared them herself—the incomes accrued either to the family or other relatives. The only exception was another widow who bought bullocks and claimed that the income accrued to her since the bullocks were registered in her name. Among the former, one respondent was emphatic that the income accruing from the asset was considered family income. It could not be ascertained whether this response was culturally conditioned (i.e., whatever belongs to a woman also belongs to the family) or simply tactful.

Repayment
Two respondents confirmed that, since the asset belonged to the family, the repayment of the loan was also a joint responsibility. The widow who owned and managed the asset herself (i.e., the owner of bullocks) was of course responsible for the repayment of the loan. The second widow (i.e., the owner of
goats), however, had no control over the income from the asset but the repayment of the loan was her responsibility.

Status
Despite limited autonomy, two women respondents reported emphatically an improvement in their status both within the household and outside. As the assets are jointly registered in the names of husband and wife, the women are seen as performing a productive role. Although the extra income earned is modest, the “cost” to women in terms of extra hours worked is negligible. No cases of violence against them were reported. Indeed, initial male resistance waned as loans augmented household incomes.

To sum up, while the benefits of enhancing the access of poor women to credit are by no means insubstantial, they are likely to be greater provided they have greater control over the assets and incomes accruing from them.

Awareness, Skills, and Training
Awareness
In general, the awareness of the MRCP was limited to a few features (e.g., it provides loans to the poor) and a small group. In the control group for individual beneficiaries, most of the respondents were unaware of the MRCP. In contrast, while the beneficiaries were better informed about this scheme, subsets of them knew little about repayment obligations. Among the members of SHGs with a good track record, all except one woman were very well informed about the objectives of the scheme, loan options, procedural requirements, and repayment obligations. But, as in the case of the control group for individual beneficiaries, members of the control group for SHGs knew virtually nothing about the MRCP. The fact that participants and nonparticipants were distinguishable in terms of awareness levels suggests that limited access to information about the scheme acted as a barrier to participation. That the barrier was harder to overcome for the poor is indicated by the fact that
they relied mostly on the Gram Sevak or occasionally on an enthusiastic field officer of a bank while others had multiple sources of information (e.g., BDOs, Panchayats, bank officials, representatives of official agencies, and mass media).

Overcoming this barrier was not enough for the poor, as the procedures (e.g., documentation, and loan sanction) took longer as well. While the nonpoor individual beneficiaries took 1 to 2 months to secure a loan, the poor took 1 to 6 months. The longer delay reflected (1) greater difficulty of document preparation, and (2) indifferent or unhelpful attitude of the bank staff.

Skills

Most of the respondents were emphatic that they did not require specialized training or skills for nonfarm activities. A few activities (e.g., making pickles, making spices, sewing, and selling vegetables) were mentioned that required traditional skills which they possessed. However, their vision was conditioned by their illiteracy and limited exposure to markets. In particular, there was little awareness of whether traditional products (e.g., pickles or handicrafts) could be more efficiently produced (e.g., as a group activity on a larger scale) or marketed better through existing channels (e.g., cooperatives) and whether there were ways of avoiding business risks (e.g., withholding supplies when the price is likely to fall). The information and training imparted by MCED, MITCON, and NGO/Sahyoginis is reviewed from this perspective.

Training

NGOs are sponsored by MAVIM or by the participating banks to nurture SHGs in the initial stages.9 Sahyoginis are the link between NGOs and SHGs. They are trained by MAVIM (as well as by NGOs). They perform a wide range of functions, e.g., awareness building, attending group and block meetings, maintaining records, training women in nonfarm activities, and arranging trips to banks. Much of awareness building and training is imparted through group discussions and demonstrations,
street plays, and cultural programs. In the sample of villages studied, the duration of training given to SHG members was 1–3 days.

Even though the interaction and training of SHG members was limited in duration, its favourable effects were noticeable. These were reflected in greater self-confidence, awareness, and willingness to undertake small businesses or trades among them. Since SHGs in the sample villages correspond largely to different caste and social groups (in other words, there is little intermixing of different castes), the composition did not come in the way. Nor did illiteracy pose any problems, given the format of training. However, it seems unlikely that SHGs can dispense with the guidance and support of Sahyoginis/NGOs. In particular, the special requirements of SC/ST households warrant greater attention and involvement.

Maharashtra Center for Entrepreneurship Development (MCED)

MCED has a different focus. It trains entrepreneurs and assists them through market surveys, documentation and management counseling. Usually, the training is given in groups of 30-60 persons. It is residential and lasts 12-13 days. Among the successes claimed, a notable case was gunny bag manufacturing by women. This had a strong demonstrative effect. However, its focus on the poor with some business experience reflected the inability of its staff to design suitable training modules for the very poor.

Maharashtra Industrial and Technical Consultancy Organization (MITCON)

MITCON's major function is to provide quality consultancy for small and medium enterprises at affordable fees. Specifically, project reports in Marathi, prepared by its staff, are supplied to potential entrepreneurs. After a project is selected, MITCON monitors its progress. Shortage of field staff—especially females—is a constraint.
Assessment

Some deficiencies came to light. The Sahyoginis were overburdened, as they covered a large number of SHGs—one of the two Sahyoginis interviewed, for example, is involved with 21 SHGs. Moreover, considering the nature of the work (e.g., frequent travel), the remuneration (Rs.1500 per month) is inadequate. Finally, as remuneration is not linked to performance, there is no incentive for them to induce the poorest to participate in the scheme. On the other hand, MCED and MITCON do not appear to be suitable for the rural poor, as their focus is largely on small and medium enterprises. Residential entrepreneurial development programs offered by MCED and supply of project reports by MITCON may be not just too exacting but also inappropriate for large sections of the rural poor—especially women—lacking literacy, numeracy, and exposure to markets. The training provided by NGOs and Sahyoginis, on the other hand, seems far more useful because of its emphasis on problem-solving skills in a village environment. An option, therefore, is to strengthen this component of training, by broadening the range of expertise of Sahyoginis, through their closer interaction with the poorest, and more remunerative salaries linked to performance.

Other Issues

Some issues that require further analysis are briefly discussed below.

1. Although some acutely poor women did not mind paying high interest rates (2–3% per month) as members of SHGs, and a few insisted that the ease of borrowing compensated for the difference between the interest paid and that charged by the banks (12% per annum), it is not clear whether the urgency of consumption and other needs (e.g., festivities or sickness) mattered too (since banks do not normally lend for such purposes). There is thus a need to examine carefully whether a more than moderate lowering of the interest rates is feasible.
2. A few responses pointed to difficulties in the repayment of loans due to seasonal fluctuations in yields (e.g., fishing) and contingencies (e.g., sickness). It is therefore necessary to supplement the present analysis through an investigation of types of assets financed by the MRCP, their retention rates, and yields.

3. The size of SHGs and their regulation are linked. If an SHG has more than 20 members, it will attract the provisions of Section 11 (2) of the Companies Act, 1956.\(^3\) As a result, SHGs usually consist of 15–20 members. Whether this is an optimal group size is not self-evident. Indeed, given the emphasis on savings mobilization, slightly larger groups may be more appropriate and not necessarily less cohesive. But, since they handle large amounts of public funds, there is a case for regulation.

4. A concern is whether group cohesiveness is synonymous with homogeneity of social background (e.g., caste affiliation) and/or economic status. In our sample, for example, there was little intermingling of different castes. But in a larger sample there were a few mixed groups that functioned well (Shankar, 2000). This suggests that under certain conditions group heterogeneity is not a barrier to group cohesiveness. An issue, therefore, is whether the village environment (i.e., whether there is a great deal of intermingling of different castes in village events, e.g., a major festival) has a role in cohesiveness. Some insights into how various forms of differentiation are overcome or why they do not matter in a certain context would be valuable for expanding the social capital (i.e., trust, reciprocity, and networks of mutually beneficial relationships) through SHGs. Appropriate policy instruments could then be devised.

**Concluding Observations**

A selective summary of the findings is given below.

1. When key correlates of poverty are applied, the nonpoor beneficiaries of individual loans under this scheme turned
out to be more than the poor. What was more surprising was
the presence of a few quite affluent persons among them.
However, SHGs with a good track record consisted mostly
of poor women.
2. Exclusion of the poorest (e.g., tribals) was partly a result
of their own lack of awareness about the MRCP and diffidence
about their ability to repay loans. But more seriously their
exclusion also reflected their social isolation, the resistance
of upper castes, and the nexus among the bank staff,
Sarpanch, and VDC.
3. Among the individual borrowers, not just the selection but
also the benefits varied somewhat depending on whether the
borrower belonged to a poor or affluent household. The loan
processing time was much longer for the poor. Moreover,
the affluent secured much larger loans.
4. The financial discipline demonstrated by the SHGs was
impressive. This was reflected in high rates of recovery of
loans both by the banks and by the groups themselves.
5. While no case of violence was reported, there were indica-
tions of male dominance in the selection and the use of the
assets.
6. Combining financial services with some forms of insurance
(e.g., against illness and accidents) would make the MRCP
more attractive to the rural poor, as their ability to deal with
contingencies is limited. Willingness to pay for additional
services is not lacking among them provided the benefits are
carefully explained to them.

To sum up, the effectiveness of a microcredit scheme such
as the MRCP is likely to depend on whether it has the flexi-
bility to induce the participation of the poorest and whether it
enables them to acquire the basic skills to benefit from it.
### Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BDO</td>
<td>Block Development Officer</td>
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<tr>
<td>BOM</td>
<td>Bank of Maharashtra</td>
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<td>BPL</td>
<td>Below Poverty Line</td>
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<td>CB</td>
<td>Commercial Bank</td>
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<td>DCCB</td>
<td>District Cooperative Credit Bank</td>
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<td>DPCC</td>
<td>District Project Coordination Committee</td>
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<td>DRDA</td>
<td>District Rural Development Agency</td>
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<td>EDP</td>
<td>Entrepreneurial Development Program</td>
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<td>FO</td>
<td>Field Officer</td>
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<td>GOI</td>
<td>Government of India</td>
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<td>GOM</td>
<td>Government of Maharashtra</td>
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<td>IFAD</td>
<td>International Fund for Agricultural Development</td>
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<td>IRDP</td>
<td>Integrated Rural Development Program</td>
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<td>MAVIM</td>
<td>Mahila Arthik Vikas Mahamandal</td>
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<td>MCED</td>
<td>Maharashtra Center for Entrepreneurship Development</td>
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<td>MITCON</td>
<td>Maharashtra Industrial and Technical Consultancy Organization</td>
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<td>MRCP</td>
<td>Maharashtra Rural Credit Project</td>
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<tr>
<td>NABARD</td>
<td>National Bank for Agriculture and Rural Development</td>
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<tr>
<td>NGO</td>
<td>Non-Government Organization</td>
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<tr>
<td>PAP</td>
<td>Peoples' Action Plan</td>
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<tr>
<td>RBI</td>
<td>Reserve Bank of India</td>
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<tr>
<td>RRB</td>
<td>Regional Rural Bank</td>
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<td>SBI</td>
<td>State Bank of India</td>
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<tr>
<td>SC/ST</td>
<td>Scheduled Caste/Scheduled Tribe</td>
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<tr>
<td>SHG</td>
<td>Self-Help Group</td>
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<tr>
<td>SYG</td>
<td>Sahyogini</td>
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<tr>
<td>SGSY</td>
<td>Swarnjayanti Gram Swarozgar Yojana</td>
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<tr>
<td>VDA</td>
<td>Village Development Assembly</td>
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<td>VDC</td>
<td>Village Development Council</td>
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Microcredit and the Rural Poor

Glossary

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<tr>
<th>Term</th>
<th>Definition</th>
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<tr>
<td>Gram Sabha</td>
<td>Village Assembly</td>
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<tr>
<td>Gram Panchayat</td>
<td>Village Council (an elected body)</td>
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<td>Gram Sevak</td>
<td>Village Level Worker</td>
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<td>Sarpanch</td>
<td>Chairperson of Village Council</td>
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<td>Sahyoginis</td>
<td>Field Workers</td>
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Notes

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1. The Integrated Rural Development Program (IRDP), operating since 1978–79, is a major credit program designed for the rural poor. However, several reviews point to its mistargeting, corruption, preponderance of animal husbandry schemes, absence of linkages, lack of adequate follow-up, and consequent high overdues of banks (Dreze, 1990; Gaiha et al., 1998; Gaiha et al., 2000; Gaiha et al., 2001).

2. The official exchange rate in 1991–92 was Rs. 17.95 to the dollar. At the time of the fieldwork in 1999–2000, it was approximately Rs. 44 to the dollar.

3. As it takes 1–3 years after a group is formed to borrow from a bank, it is not surprising that out of a total of 2006, barely 815 SHGs were linked to the banks (UNOPS, 1998).

4. Income in the hands of women has different effects on household decision making than income accruing to men. For instance, wage employment is generally observed to result in improved women’s bargaining position within the household and in higher energy intakes for children. For a review of the evidence, see Deolalikar and Gaiha (1996).

5. The classification of households into poor and nonpoor takes into account these characteristics as well as whether household income was ≤ Rs. 12,000 per annum (for a household of five) at current prices, among others.

6. Going by IFAD (1997), a share of non-BPL households exceeding 20% is considered excessive.
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7. Note that the group of SHGs not functioning satisfactorily (abbreviated as NFS) is classified as the control group. The observations that follow are therefore confined to SHGs functioning satisfactorily (abbreviated as FS).

8. What is interesting to note is that repayment rates for individual borrowers were nearly as high. The reasons include VDC monitoring of loans, loss of reputation of defaulters, and the realization that the loans had to be repaid.

9. Each NGO is assigned six villages under the MRCP.

10. One Sahyogini (operating in Mohkal) pointed out that attempts to reduce her contact with SHGs caused confusion among the members. This is plausible, as it was corroborated by two representatives of financial institutions as well.

11. Alcoholism among men and women, attachment to traditional practices, and low acceptance of strangers makes establishing connections with tribals more challenging. (I owe this observation to Shylashri Shankar).

12. No company or association or partnership consisting of more than 20 persons shall be formed for carrying on business that has for its object the acquisition of gain by the company or by the individual members thereof, unless it is registered under the Act.

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Book Review

Mainstreaming microfinance: How lending to the poor began, grew, and came of age in Bolivia.
by Elisabeth Rhyne

by Monty L. Lynn

When many are asking what’s the next level in microfinance delivery and who’s going there, Elisabeth Rhyne offers some illuminating perspectives from Bolivia.

Microcredit programs sprouted throughout Latin America in the mid-1980s, providing to date over 13 million small-scale business and agricultural loans. During the past decade and a half, FINCA, Acción, and other regional and international organizations have been delivering microfinance services from Chile to Mexico. But in the Bolivian caldron, ingredients mixed just so to produce a large and competitive microfinance market, a restructuring of the country’s broader finance sector, and a detectable and growing presence of microfinance in Bolivian macroeconomic indices. In short, the Bolivian experience offers a window into the future and lessons along the way for increasingly commercialized microfinance industries.

Writing with journalistic grace, eminently qualified author Elisabeth Rhyne chronicles the story of Bolivia’s microfinance developments from the mid-1980s to the year 2000. Her story is grounded in survey trips to Bolivia in 1999 and 2000, economic data, and personal experience. Rhyne deftly connects with the microfinance novice, the seasoned practitioner, the
policy maker, and the academic, although the macroeconomic analysis for the latter two is understandably light considering the availability of precise data. The author’s attention is evenly divided between the past, present, and future of Bolivian microfinance. The historical description reads like a dynamic travelogue rather than bogging down in a swamp of details. It often is as prescriptive as it is descriptive, but without distorting the portrayal.

Rhyne’s focus is not on history, per se, but rather on chronicling how various microfinance philosophies and methods have played out; how culture, politics, and the marketplace empowered some initiatives and obstructed others; and how technologies hit or missed the target in various settings. Some of the milestones Rhyne highlights in Bolivia parallel the industry’s evolution in other locales: the entrance of microcredit NGOs; the launching of “Bolivia model” credit institutions; adding microsavings services; escalating competition in microfinance delivery; debtors associations rising in protest; the weakening of lenders by a consumer lending crash; shifts from a sellers to buyers market; the entrance of retail banking; and the shift of attention to rural delivery.

Rhyne clearly favors the financial services approach to microfinance, where institutions are self-sustainable and profit minded. But she also engages the topic of goal displacement in humanitarian-turned-financial organizations. She recognizes the challenges of replicating any effort’s “unpredictability of progress, its dependence on individual leaders, and its continued vulnerability to setbacks and shocks.” And she acknowledges that Bolivia—like any country—is sui generis. Its low ranking on economic indicators in Latin America, its high percentage of indigenous Quechua and Aymara and its landscape, history, and culture all create a unique milieu for microfinance.

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Nevertheless, it is clear that “The Bolivian microfinance story offers a mother lode of experience relevant to microfinance and development beyond Bolivia’s borders” (p. 199). In an industry where a proliferation of independent effort doesn’t always favor sharing and adopting best practices, a careful, insightful, and enjoyable analysis such as Rhyne’s sheds much light, particularly on the Latin American scene.

Book Review

_Grameen Bank and Women’s Empowerment in Bangladesh: A Review Essay_

by Asif Dowla

The success of Grameen Bank, a flagship organization providing collateral-free credit mostly to women in rural Bangladesh, has led to a burgeoning literature spanning many disciplines. One strand of the literature deals with theoretical issues in economics, such as the use of joint-liability contract and social collateral by the bank to circumvent the problem of asymmetrical information inherent in all financial transactions. Another track of the literature examines the economic impact of the bank on the borrowers and their communities. Yet another group of papers examine the social impact of the bank, especially its effect on the empowerment of women in Bangladesh. The book, _Women and Microcredit in Rural Bangladesh: Anthropological Study of the Rhetoric and Realities of Grameen Bank Lending_ by Aminur Rahman belongs to this latter group. The major thesis of the book is that the public reason for Grameen Bank’s targeting of women—empowerment and betterment of their lives—is at variance with actual practices. Another theme, though not as well developed, is that the bank’s attempt to reach financial sustainability is creating increased debt burden for its borrowers and is in conflict with its original mission of poverty alleviation.

This provocative book is the outgrowth of the author’s Ph.D dissertation based on thirteen months of ethnographic field research on Grameen Bank’s lending in one village. The main theoretical tool used is that of public and hidden transcripts—the
The official policy of the bank is that the borrowers will self-select the members of their borrowing group. The author contends that the practice of “group recognition” by a superior officer of the bank suggests that the hidden transcript is that it is the bank officer who really decides on the exclusion, inclusion, or replacement of borrowers, not the women themselves.

He reports that outside male bank workers, because of patriarchy, cannot recruit local women for participation in the credit program directly. The staff is forced to contact women through the mediation of male members of the households, most often husbands. This, the author argues, creates a power hierarchy between bank worker and early organizers of loan centers, and it is used for loan approval and installment collection. He suggests this is another example of the discrepancy between public and hidden transcripts.

The author finds anomalies between the public and the hidden transcripts in the social development goals of the bank as well. For example, officially borrowers are supposed to shun the practice of accepting and giving dowry. The author found numerous examples of borrowers accepting and giving dowry, again contradicting the public transcript. Similarly, many borrowers did not stick to the announced practice of using the pit latrines. In many cases, because of the condition imposed by the bank (one pit latrine per housing loan), a family has more than one pit latrine as many of them have more than one housing loan.

According to the official policy of the bank, the staff will supervise the borrowers to ensure that they use their loans for income generation and pay installments from their earned

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income. The author found little evidence of loan-use supervision by bank workers. In fact, his research found that 78% of loans in the village he studied were used for purposes other than those approved by the bank. In addition, the author reports that in a majority of cases, women pass along their loans to men or male relatives. The public transcript of the bank suggests that borrowers own the bank, but the hidden transcript is that many borrowers do not understand what it means to be owners, despite the fact that they nominally own shares, and that the ownership is meaningless, as they don’t receive any dividends from their shares. The public position of the bank is that female members are the majority on the board of directors (9 out of 12) but the hidden transcript is that these uneducated women are powerless in the face of the minority of male board members. The author reports that participation in credit programs has led to an increase in both verbal aggression and physical assault for a majority of the women. The increased pressure for timely repayment creates tension among household members and at times leads to verbal and physical aggressions against women. This is yet another example of the anomaly between public and hidden transcripts.

Of all the things in the book, I found the statement that Grameen Bank targets woman to take advantage of their “positional vulnerability” the most disturbing and unfortunate. He alleges that bank workers use this vulnerability to recruit and extend loans and the men in the households rely on it to use women’s loans and to pay their installments. Unfortunately the author does not provide any solid evidence to back up his claim. His only evidence is statements from the bank workers who tend to justify avoiding recruitment of men, but even they never claim that women are targeted because they have limited mobility and a greater sense of shame. The author does not report if he ever asked the women themselves why the bank targets them and if they concur with his hypothesis.

Another weakness of the book is that it is based on the study of one village and as a result it suffers from fallacy of
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composition—what is true for one village may not be true for all villages where Grameen Bank has a branch. Village studies in itself are very useful as they help to understand the dynamics and the qualitative changes that occur when poor women have access to credit. This book was successful in that respect. However, the author failed to underscore the inherent limitation of studying one village and failed to warn the reader not to generalize the conclusions.

Women in rural Bangladesh are, in general, shy and appear submissive. However, the author failed to point out how this changes dramatically once they become members of Grameen Bank. In fact, Grameen borrowers who have been in the bank for a longer period are almost always less shy and dominated, and more assertive, than those who have recently joined. To quote Achia, one of author’s respondents:

Before I joined the bank, I was very introverted and shy to speak in front of people. When I came to my husband’s homestead ten years ago, people used to gossip about my quietness. After I joined the bank I have started to change my behavior. Within five years with the loan center I have become more vocal. In the center we meet different members, we talk with each other, we quarrel with each other, we fight for each other’s kisti, which makes one more open and vocal. Now I am the center chief, and shouting and screaming at other members is my regular job at the center meetings. In fact, the survival needs in the center makes one more vocal and self-expressed. (p. 95)

Afterward, even the author concedes, “Grameen borrowers in general are more vocal and articulate compared to other women in the village who are not Grameen members” (pp. 95–96).

Grameen Bank had to face the same patriarchal norm that the author mentions to implement its policy to target mainly women. In its earlier days the bank faced opposition from hus-
bands and religious leaders for its policy of lending almost exclusively to women. Even highly educated civil servants and professionals were opposed to lending money to women while so many men were jobless and without income. “One official of our central bank even wrote me a menacing letter demanding that I ‘explain fully and immediately why a high percentage of your borrowers are women.’ Curiously, my reply asking whether the central bank had ever asked the other banks in the country why they have such a high percentage of male borrowers went unanswered” (Yunus, 1999, p. 73). Even the harshest local critics of Grameen Bank concede that the biggest achievement of Grameen Bank is the empowerment of women, not enchainment as suggested by the author.

We are told repeatedly that the dominant patriarchal norm is hard to break and Grameen is only perpetuating this norm. The author does an excellent job of explaining why the patriarchal norm is dominant. Instead of suggesting that Grameen Bank is perpetuating the stranglehold of the norm, the author should have pointed out how and to what extent the bank has weakened the patriarchal norm. Readers are never told how Grameen is slowly eroding the patriarchal norm and, even after two decades of existence, still has to fight that norm. Contrary to what Rahman’s hypothesis might suggest, the situation has improved more for women members of Grameen Bank, though perhaps not as much as some of its adherents sometimes claim. At a minimum, membership in the bank enabled women to get out of their homesteads to conduct business with an outside male for an extended period without being accompanied by a male relative. Anyone who visits a village where Grameen Bank and other NGOs are in operation is struck by how patriarchy has been put on the defensive, if not entirely defeated. How this happens, and why it is not happening faster, are exciting subjects for further study.

Pursuant with his theme of dominant patriarchal norms, the author criticizes the policy of electing uneducated women to the board of the bank. Not many banks in Bangladesh,
indeed even banks in the USA, can claim to have 9 out of 12 female board members. Granted these women may not understand the intricacies of modern finance, but they are smart and savvy enough to understand the ramifications of policy changes at the field level. Putting women on the board will not change the country’s historical norm of male domination overnight. But it is a symbolic change and a very good beginning at that. The author’s own data reveals the efficacy of the policy quite effectively. In chapter 5 he tells us the story of a member—Sofia—who organized most of the centers in the study village and controlled the loan operation of these centers through her informal network. She was so “empowered” that the patriarchal male bank worker had to “listen to her decisions about new loan approvals, and use her influence in their centers to collect installments” (p. 86). Then later in chapter 7 the author seems to share the frustration of the bank worker that Sofia did not get elected to the board even though she was elected as a candidate by the borrowers of her own branch and seven other branches. I wish the author had also reported the feelings of the borrowers in the study village when Sofia did not get elected to the board. I would not be surprised if the borrowers themselves did not also feel “disappointed, because if Sofia had been elected it would have brought status and encouraged pride for the study branch” (134–135) as did the bank workers. If this is not a sign of empowerment I don’t know what is.

He chides the bank appropriately for not having enough female staff and suggests that this is another example of the discrepancy between public and hidden transcripts. The author’s own story suggests why it is so difficult for a female to hold a job as a bank worker in rural Bangladesh. He describes a public fight between a center chief and the husband of a borrower, and how the female bank worker failed to stop the fight. These verbal altercations later led to a fight between the two lineages in the village (p. 125). The patriarchal norm that Aminur criticizes is the biggest hindrance to recruitment of female staff.
He is justified in criticizing the attitude of male bank workers who perpetuate the stereotype that female workers are not as effective as male workers. A possible way to increase female staff will be to recruit locally. Local recruitment might create precisely the kind of problem that the author was alluding to—bank staff colluding with their relatives or members of their own clan to control access to credit, or local staff being caught between their obligation to local forms of domination and serving the bank’s mission. To avoid these conflicts, Grameen, as a policy, does not hire staff locally and male bank workers are not allowed to work close to their home villages. But this argument cannot be used to explain why more female staff cannot be hired at the head office.

The accusation that the majority of women pass on their loans to men has been made before. But to claim that this somehow precludes women’s empowerment is a mistake. It suggests that women are empowered only if they always use their loans independent of men. This dichotomous indicator of empowerment does not match the reality of life in rural Bangladesh. Households in Bangladesh are managed jointly even though men dominate in the distribution of authority and decision making. In this context, a more realistic measure of empowerment via credit would be to evaluate whether credit has had an equalizing effect on household decision making.

The allegation of increased incidence of violence as a result of membership in the bank is equally problematic. Because there is no benchmark, we cannot definitely say whether violence has increased. It could well be true that the increased incidence of violence may be a nationwide trend. The author himself reports that violence has decreased for some members, a finding other researchers have confirmed. Arguably, scarcity within the household is the major source of men’s violence against women. Previous studies as well as Kabeer’s analysis (1998) clearly show that credit has a powerful mitigating effect on this source of violence, because it helps to reduce scarcity. Interestingly she found that the incidence of violence increased.
for women who were speaking up and questioning male authority for the first time, empowered by credit.

In the end, the author himself falls victim to his own methodology. He has his own public and hidden transcripts. In the main body of the book (chapter 6) he criticizes the bank’s policy of collecting interest payments and subscription to emergency funds in the last weeks of the loan cycle. Then in the endnotes he writes “By the end of 1996, the Grameen Bank had modified the repayment terms. Now the interest payments are spread over fifty weeks and accepted with the installment payments. Collection for an emergency fund was terminated in 1996” (p. 127). He does not tell us what led to this policy change. The actual cause behind the policy change was a protest by borrowers in Tangail. Another change in policy that occurred as a result of this protest is that borrowers were given ownership of savings in the group fund after ten years of membership. This shows that when the members’ hidden transcript became a public transcript through organized protests, the bank changed its policy. Earlier we mentioned the author’s reservation about the effectiveness of having poor illiterate women on the board of directors. Putting women on the board is another means through which a hidden transcript can be made public.

I found chapter 7 the most interesting part of the book. In this chapter the author shows that there is a short-term trade-off between sustainability, and poverty alleviation and empowerment. He does a good job of explaining how the objective of achieving sustainability too rapidly can undermine the original social mission of poverty alleviation and empowerment of women. Critics of microfinance argue that to attain greater outreach, MFIs have to be sustainable at any cost. Aminur suggests that to meet the challenge of financial sustainability, bank workers “employ coercive methods and use local power hierarchies in installment collection and loan investment instead of the borrower empowerment and solidarity envisaged by the banks in its public transcript” (p. 127).
The book shows that trying to achieve sustainability by “scaling up the outreach” created problems for Grameen Bank. The increased pressure for enhanced disbursement prompted the bank’s staff to ignore well-known policies of the bank, for example, not to approve loans that exceeded borrowers’ capability to repay and not to give loans to persons who do not meet the official criteria. The author suggests that to attain sustainability the staff gave multiple loans to the same member. This created the problem of cross financing, i.e., using one loan to payoff another loan, and increasing the debt burden for the household. Given the insecurity and uncertainty that comes with living in rural areas, the debt burden had adverse consequences for the welfare of the household and many households are falling in a trap of perpetual debt cycle. The pressure of sustainability, again, led to disbursement of loans to the better-off households. Since better-off households have less to loose by defaulting, this created serious problem in maintaining the repayment rates. In other words the bank ended up in a vicious cycle of increased disbursement to increased default to increased lending to better-off households to further increased default.

The findings of the book provide some valuable lessons for Grameen and MFIs in general. It suggests that the increased size of the organization is severing the chain of communication between borrowers, staff in the field, and upper level management. During the early days of the bank, a worker could and did communicate his or her personal observations to the managing director. Many of the early innovations and ideas came from these types of communication between bank staff and upper level management. As the staff has grown to 13,300, these types of open and constructive exchanges have become much more difficult.

The most worrisome finding from this book as well as from other researchers is that a collusive arrangement is developing between bank workers and influential borrowers, with the latter using this to foster their own interests and expand
their own influence and networks. The author describes in detail how this power hierarchy develops (p. 84). The reason for keeping the group size limited to five people and for the rotating of center chiefs was to neutralize the influence of one or a few borrowers. As a policy, staff are rotated among centers every year and they are transferred out of a branch after three years, a practice that is followed to avoid the problem of collusion between staff and the members. The book suggests that the attempt is failing.

Another finding of the book is that the members are unaware of many of the policies and their implications. Because of the pressure to attain sustainability, the workload of the staff has increased enormously. They have less time to explain the policies and procedures and to provide social intermediation, i.e. to give advice on loan use, and so forth. Many members feel that the bank has lost sight of its mission and has become a bank of loan collection only. This is quite unfortunate because the bank is losing the trust of the members that it has worked so hard to attain. At the end of the book the author writes, “The Grameen Bank has shown past capacity to bring changes in its policies; it therefore holds the promise to incorporate the policy recommendations of this research for the betterment of the institution and its poor borrower” (p. 153). I want to end this review by agreeing with the author entirely on this point and by expressing similar optimism.
Notes

I am grateful to Jonathan Conning, Michael Cain, Tanweer Akram, and Dustin Buehler for comments.

1. As of May 2000, Grameen Bank is in operation in 40,032 villages; this amounts to more than half of the villages in Bangladesh.

2. Naila Kabeer (1998) provides an excellent survey of the literature on credit and women’s empowerment in Bangladesh. Her main thesis is that both the negative and positive evaluation of women’s empowerment through credit misses out an important dimension of the problem—women’s own perception of what credit does to their lives.

References


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