Journal of Microfinance

Vol. 4 No. 2  Fall 2002

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Unfinished Business

The Need for More Effective Microfinance Exit Monitoring

by James Copestake

Abstract: High rates of exit remain the "Achilles heel" of many microfinance organizations. After reviewing definitional issues, the paper explores how exit rates adversely affect both their commercial and social objectives. It then reviews case studies of exit monitoring based on routine, questionnaire based and focus group methods, making detailed suggestions as to how data collection, analysis and reporting can be improved.

Introduction

No single financial service package is ever going to be a panacea and so turnover among users is inevitable. This is particularly the case for relatively poor users, who are generally more vulnerable to risks and shocks, and also limited in their capacity to purchase savings, credit, and insurance services. Nevertheless, microfinance organizations (MFOs) should generally aim to satisfy most of their customers most of the time. This requires that they listen and learn from those who leave as well as those who remain.

The majority of MFOs have indeed woken up to the fact that they do not have a natural monopoly, that their survival hinges upon innovation, and that this in turn requires that they respond flexibly to actual and potential demand.1 This paper nevertheless suggests that the issue of exit monitoring
remains "unfinished business" for two reasons. First, the extent to which high exit rates adversely affects both commercial and social goals of MFOs is still understated. Second, current exit monitoring practices remain weak. The middle sections of this paper develop these arguments in turn. The last section concludes with a set of specific recommendations for MFOs and for the industry more generally. These include the case for (a) investing more in exit monitoring, (b) doing so more systematically and routinely, (c) being more consistent in definition and measurement of exit and related concepts, and (d) improving the reliability and cost-effectiveness of protocols for collection and analysis of data on why people leave.

The context of this paper is an ongoing action research project called Imp-Act, sponsored by the Ford Foundation and involving a network of more than thirty microfinance organizations in Eastern Europe, Asia, Africa, and Latin America. In addition, the paper draws on case-study material from exit studies of village banking organizations in Malawi and Zambia.

It is useful to start by considering precisely what the term "exit rate" (E) means. The most commonsense definition is the percentage of a specified population of users of a service in period T who do not continue using the service during period T+1. Its opposite, the retention rate (R), can be defined as the percentage of users of a particular service in period T who continue to use it in time T+1. Four complications then arise.

First, exit and retention rates vary according to the time interval adopted for their measurement. To illustrate, consider the case of a village bank that provides loans on a routine 16-week cycle. It then seems obvious to define the exit rate as the proportion of borrowers in one cycle not taking a loan in the next cycle. But the interval between cycles is not fixed. This is because the struggle to repay one external loan to the village bank often delays receipt of the next loan. It follows that it is

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better, where possible, to measure exit rates over a standard period of time, say a year, or at least specify the time interval to which a particular statistic refers. However, the task of converting an exit rate for one interval to another is complicated by the possibility that some users may return. For example, take the simple case of a new village bank with 25 members who complete three full cycles in their first year. If 10 members take a loan holiday during the second cycle, and 5 different members in the third cycle, then exit rates are as follows: first-second cycle, 15/25 = 60%; second-third cycle, 5/15 = 33.3%; first-third cycle, 5/25 = 20%. Yet if they all signed up for a fourth loan by the end of the calendar year, then the annual exit rate would be zero.

Second, it is necessary to specify precisely the nature of the financial service. In the above case, for example, it may be that while several members took a loan holiday they continued to make savings into the village bank, attend meetings, and participate in internal loan activities. If so, then it could also be argued that cycle to cycle membership exit rates were zero between each cycle as well as over the whole period. The implication is that any exit rate statistic should not only specify the interval but also the particular service to which it refers.

A third issue concerns the level of aggregation. Exit rates may be high at the group level, but reflect high rates of switching from one group to another. Indeed this may actively be encouraged as part of the process by which members seek to associate with others who have a similar risk profile. For example, strains may appear in a village bank that is trying to accommodate richer or more dynamic members with rapidly growing debt capacity alongside those who cannot afford the risk of taking on larger loans themselves, not to mention the risk of guaranteeing the even larger loans of others.

Fourth, where possible it is useful to distinguish between exits that reflect negative or positive/neutral experiences of the user. Combining this and the distinction between permanent and temporary exit produces the four categories of leavers.
summarized in Table 1. The exit rate is both objectively measurable and neutral with respect to why users leave and for how long. In contrast, both future intentions (to rejoin or not) and past experience (good or bad) can only be assessed subjectively whether by leavers themselves or by remaining users or staff. But where possible, routine classification of exit into these four categories makes it much more useful to monitor exit rates over time or compare them between user categories, groups, branches, affiliates or different MFOs.

It is clear from this discussion that the task of routinely producing comparable exit rates is far from trivial. How much time and effort it is worth investing to produce more detailed data depends on its usefulness, to which we now turn.

Why Find Out More?

Commercial Implications of a Rising Exit Rate
A rising exit rate may indicate major problems for an MFO and even threaten its survival. Users may be unhappy with terms and conditions or with relations with staff. They may be switching to competitors, or overall demand may be falling due to a change in the economic climate. On the other hand, high and rising exit rates may be offset by rapid growth in the number of new and returning users.

The short-run financial cost of losing a client is equal to the resulting loss of future revenue minus marginal cost savings. Since these figures vary widely, MFOs need to develop a
typology of users, monitor exit rates from each type, and estimate the net revenue loss per user for each.

Such calculations also influence estimates of total net revenue from different types of users, and so have implications for marketing and user selection policy. There are usually fixed costs associated with recruiting and inducting a new user. So if exit rates for different types of users increases, then the case for incurring these costs needs to be reviewed.

In the longer term, changes in exit rates also affect reputation and goodwill. Leavers may spread stories that deter others. High exit rates associated with adverse welfare effects on users may also scare away potential investors (from the private sector as well as donors) who are jealous of their reputations. This may raise the cost of capital and possibly also the cost of compliance with regulation. An increase in exit rates may also be a lead indicator of a more widespread loss of goodwill among users, which may subsequently lead to contract enforcement problems or even political hostility.

It is worth illustrating some of these points numerically. For simplicity, consider again the case of a village banking organization. A key determinant of commercial viability is staff productivity, and high exit rates are likely to reduce this because of fixed costs associated with induction and screening of new members. In other words, high exit rates increase the effort required to achieve organizational level economies of scale by increasing the total portfolio. Table 2 shows the implications of different cycle-cycle loan exit rates for a village banking organization (VBO) that recruits 100 new members per cycle, assuming no rejoining. With a 30% cycle-cycle exit rate, the total active membership grows to 472 in 15 cycles, whereas with a 10% exit rate, growth is to 794. At the 30% exit rate, the portfolio stabilizes with just over half the membership at any time having completed three cycles or more, whereas with the ratio at a 10% exit rate, the ratio exceeds two thirds.
Table 2. Simulated effect of exit rates on user growth and composition

<table>
<thead>
<tr>
<th>No. of cycles</th>
<th>Total number of VB members</th>
<th>Recipients of three or more loans (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10% Exit</td>
<td>20% Exit</td>
</tr>
<tr>
<td>3</td>
<td>273</td>
<td>244</td>
</tr>
<tr>
<td>6</td>
<td>469</td>
<td>369</td>
</tr>
<tr>
<td>9</td>
<td>613</td>
<td>433</td>
</tr>
<tr>
<td>15</td>
<td>794</td>
<td>482</td>
</tr>
</tbody>
</table>

A further factor is the tendency for more established users to graduate to larger loans, resulting in faster portfolio growth and reduced unit costs. Table 3 continues with the same hypothetical example but makes the additional assumption that starting loans are $100 and are increased for repeat borrowers by a standard cycle-cycle loan increment rate of 20%. With a 30% exit rate, the average loan size rises to $138 after six cycles, but then drops to $126 after 15 cycles. At an exit rate of 10%, in contrast, average loan sizes rise to $157 after six cycles, and continue rising to $233 after 15 cycles.

Table 3. Simulated effect of exit rates on average loan size

<table>
<thead>
<tr>
<th>No. of cycles</th>
<th>10% exit</th>
<th>20% exit</th>
<th>30% exit</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>120</td>
<td>118</td>
<td>116</td>
</tr>
<tr>
<td>6</td>
<td>157</td>
<td>147</td>
<td>138</td>
</tr>
<tr>
<td>9</td>
<td>185</td>
<td>160</td>
<td>138</td>
</tr>
<tr>
<td>12</td>
<td>209</td>
<td>161</td>
<td>132</td>
</tr>
<tr>
<td>15</td>
<td>233</td>
<td>159</td>
<td>126</td>
</tr>
</tbody>
</table>

Note: Amounts are in dollars. Starting loan size is $100 and is increased for repeat borrowers by a standard cycle-cycle loan increment of 20%.
These simulations need to be interpreted with care because in practice exit rates and loan increment rates are not independent of each other. Rather, high exit rates may reflect a process of actively excluding those members with least capacity to absorb larger loans. Thus a more realistic characterization of policy choice is to compare average loan sizes for a strategy of: “growth through fast loan increment rates with high exit rates” with “growth through low increment rates with low exit rates.” In other words, high exit rates may be in the financial interest of the MFO to the extent that they reflect successful screening out (in the presence of information asymmetries) of those members with less debt capacity who are likely to be less profitable.11

This discussion raises questions about the scope for different providers to position themselves within a dynamic market. Where competition is limited, screening out poorer and less profitable members may be financially advantageous. But when competition becomes more acute, it may become an unaffordable luxury. The challenge is then to differentiate products and services to reflect the requirements of diverse types of user.12 More generally, it is clear that such strategic positioning needs to be informed by reliable information on who leaves and why.

Exit Rates and the Wellbeing of Users
Mention has already been made of the commercial risks of being associated with users who leave because they are made to suffer. Of course, for MFOs the wellbeing of their users is also a goal in itself—often the prime goal. High or rising exit rates should then be a cause for additional concern, because they are likely to indicate that users are dissatisfied with the quality of the services they are receiving. However, caution is again needed in interpreting data. Exit rates may also reflect a high rate of graduation—if some users’ situation improves enough for them to be able to reduce debts, precautionary savings and insurance cover then so much the better. Flexible services that
allow resting (loan holidays, for example) are also generally to be welcomed.

A hard headed liberal position is that if an MFO is itself financially self-sustainable, then it is also likely to be welfare improving, regardless of turnover of its users. Hence there is no need to worry about exit on welfare grounds at all. The argument relies heavily on the principle (of caveat emptor or buyer beware) that users should be responsible for the consequences of their own actions: benefits outweigh costs if their judgement is good, and if it is bad then they must learn the hard way. Few would dispute that individuals should have the freedom to join new initiatives, such as a local village bank, if they so desire. If joining turns out to have been a foolish act of bravado, or if they joined with inadequate understanding of the risks, then they should generally also bear some responsibility for the consequences of their decision. And as the provision of microfinance services becomes more competitive, so rising exit rates may reflect a welcome widening of consumer choice.

One of the attractions of this argument is that it greatly simplifies the task of evaluating whether investment in expanding the scale of such services is successful or not. So long as users are free to leave, so the argument goes, then the long-term commercial performance of the MFO itself is sufficient evidence of whether investing in it yielded wider net social benefits or not. Thus it is not necessary for public accountability purposes to engage in the tricky and expensive task of researching impact in other ways.

However, this minimalist point of view may be challenged on various grounds. Markets for financial services are rarely perfectly competitive. Providers are particularly likely to enjoy some monopoly power in slums and remote areas—indeed it may be a necessary inducement for them to work there. Users may also have little prior information and experience of the details and long-term implications of the contracts they enter into, and they may do so in desperation. They may
then not be in a position to force compliance with the terms of their contracts, a particularly important consideration when it is the user who makes initial payments. In sum, there are good grounds for believing that in rapidly changing markets many vulnerable users are likely to assume debts that ultimately do them more harm than good. And while they may be free in theory to leave, the financial and social costs of doing so may be high.

For these reasons most practitioners do accept the need to monitor “outreach” of MFOs over time as well as their financial performance. But what is meant by outreach and how does it relate to exit rates? Navajas, Schreiner, Meyer, GonzalezVega, and RodriguesMeza (2000) distinguish between breadth, scope, worth to users, cost to users, depth, and length. Breadth refers to the number of people with access to financial services at any moment in time and is relatively unproblematic. Scope, worth, and cost together determine the quality of the services in terms of the change they have on users’ well-being during any period. Depth takes into account the tendency for policy makers to give higher social value to such changes if they affect poorer people. That leaves length of outreach, which sounds like the aspect most relevant to our concern with exit rates. Navajas et. al (2000, 336) explain its significance in the following way:

Length of outreach is the time frame in which a microfinance organization produces loans. Length matters since society cares about the welfare of the poor both now and in the future. Without length of outreach, a microfinance organization may improve social welfare in the short-term but wreck its ability to do so in the long-term. . . more length requires more profit in the short-term. This means higher prices, more costs to users, and less net gain per user. . . . The debate over the social value of sustainability hinges on the effect of length.
A problem with this definition of length of outreach is that it is defined solely from the point of view of the provider of services. In so doing the authors implicitly assume that exit rates are irrelevant so long as net access is growing over time. This hides a strong value judgement about the relative worth of those who enjoy sustained access compared to those who “enjoy” temporary access and exit for negative reasons. Consider the numerical example presented in the last section. After 15 cycles with a cycle-cycle exit rate of 20%, 482 active members will remain of the 1,500 joiners, only half of whom will have taken more than three loans. Assuming a loan increment rate of 20% then the average loan size will have more than doubled to $233, but at what price to all those exiting?

To sum up, an understanding of how many users leave and why is essential for any balanced judgement about the overall welfare impact of microfinance services. In other words, exit data is potentially useful not only for the purposes of market research but also informing public policy on the trade-offs such programmes entail. But it is perhaps possible to go further. If policy makers have an understanding of cost of provision, breadth of outreach, depth of outreach, and why people exit, then perhaps the need for information on quality of outreach is greatly reduced. Studies to assess impact or quality of outreach are extremely difficult to do reliably and cost-effectively. So the question arises, to what extent does exit monitoring offer a more reliable and cost-effective alternative?

**How to Find Out More?**

A regular flow of explanations for changes in exit rates inevitably filters through any MFO informally. But such feedback is subject to bias for two reasons. First, it will be unclear how representative different explanations are of the overall picture unless the process of internal listening is unusually systematic. Second, staff may themselves be a factor in explaining why users are leaving, and their explanations will carry
their own strategic bias (see below). Hence more systematic data collection and analysis will usually be justified.

Making good the deficit of information about who leaves and why presents MFOs with a series of interrelated methodological issues. This section highlights the following issues in turn: how to build exit monitoring into management information systems; choosing between different methods for collecting supplementary data; and framing questions so as to facilitate data analysis and interpretation.

### Table 4. Variation in exit rates by loan cycle.

<table>
<thead>
<tr>
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<th>2nd</th>
<th>3rd</th>
<th>4th</th>
<th>5th</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Village banks</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>20</td>
</tr>
<tr>
<td>Total current cycle membership</td>
<td>66</td>
<td>104</td>
<td>136</td>
<td>131</td>
<td>437</td>
</tr>
<tr>
<td>Last-to-current cycle exits</td>
<td>23</td>
<td>40</td>
<td>40</td>
<td>28</td>
<td>131</td>
</tr>
<tr>
<td>New intake in current cycle</td>
<td>25</td>
<td>13</td>
<td>37</td>
<td>21</td>
<td>96</td>
</tr>
<tr>
<td>Last cycle membership</td>
<td>64</td>
<td>131</td>
<td>139</td>
<td>138</td>
<td>472</td>
</tr>
<tr>
<td>Last-to-current cycle exit rate</td>
<td>35.9%</td>
<td>30.5%</td>
<td>28.8%</td>
<td>20.3%</td>
<td>27.8%</td>
</tr>
<tr>
<td>Members exiting after one loan</td>
<td>23</td>
<td>14</td>
<td>20</td>
<td>13</td>
<td>53.4%</td>
</tr>
<tr>
<td>Members exiting after two loans</td>
<td>0</td>
<td>26</td>
<td>14</td>
<td>6</td>
<td>35.1%</td>
</tr>
<tr>
<td>Members exiting after three loans</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>5</td>
<td>8.4%</td>
</tr>
<tr>
<td>Members exiting after four loans</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>3.1%</td>
</tr>
</tbody>
</table>

For further discussion of this particular case study see Copestake et. al (2002).
Building Exit Monitoring into Management Information Systems

The first question to consider is how far exit monitoring can usefully be integrated into the system for monitoring overall relations between users and the MFO. The best option will obviously vary between MFOs, not least according to their varying commitments to computerization and to devolving both information and decision making power. More centralized organizations (FINCA, for example) keep computerized records of savings, loans and other services being used by individuals from which exit rates can be generated. This information may also be supplemented with information from exit forms that leavers are required to answer before having savings returned to them. By combining such information with data collected when users first joined, it may be possible to analyze statistically the characteristics of those who leave in the same way as organizations analyze defaulters for, say, credit rating purposes.¹⁴

More modestly, it is useful for village banking organizations to monitor how exit rates vary according to both the age cohort of village banks, and of individual users. Many MFOs cannot yet produce the “joined up” data necessary to produce such information quickly, cheaply, and routinely. Meanwhile estimates of exit rates have to be based on sample data extracted often painstakingly from paper records. Table 4 illustrates. It summarises information on exits between the current and last loan cycles from twenty village banks in Zambia: five selected randomly from all village banks currently in their 2nd, 3rd, 4th, and 5th loan cycles. Last-current cycle exit rates are first calculated for each village bank age cohort and show a declining trend with age from 36% after the first cycle to 20% after the fourth. The second panel of data reveals that these statistics hide the fact that most exits are accounted for by those who had only completed one or two cycles—even in the older village banks. Thus one recommendation of this particular
Unfinished Business

Table 5. Ranking of data collection methods relative to key issues.

<table>
<thead>
<tr>
<th>Issues</th>
<th>Structured Individual Interviews</th>
<th>Focus Group Discussion</th>
<th>In-Depth Case Studies</th>
</tr>
</thead>
<tbody>
<tr>
<td>To reflect diversity of experience among leavers</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>To reflect depth and complexity of experiences among leavers</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>To facilitate staff learning and be of direct operational use</td>
<td>3</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>To facilitate analysis and complement data from other sources</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>

For more details on this study see Copestake et. al (2001a).

study was that more attention needed to be paid to the induction of new members into old banks.

Methods of Primary Data Collection.
Where exit forms containing questions about why users decide to leave are not filed routinely, the only alternative is to collect such data on a sample basis. This section explores three methods for doing so: structured individual interviews using a predetermined questionnaire; focus group discussions and use of participatory techniques; and in-depth case study interviews.
with individuals based on "long" or semi-structured questionnaires.

Choosing an appropriate combination of the three depends on the balance between costs and usefulness, with the latter depending in turn on relevance, reliability, and timeliness. The issue of reliability can in turn be broken into two problems: how to avoid sampling bias (or reflect the diversity of leavers' experience); and how to do justice to the multiple causes behind each leaver's experience and avoid biased responses. Reducing these problems can be expensive, and since resources are always limited a judgement is needed about what constitutes an optimal level of ignorance. Cost considerations dictate that attention is paid to ensure that data is as directly useful as possible, and that the method can be replicated easily over time. Two important issues here are whether the process of data collection is itself useful for those involved or purely extractive and how effectively the data can be combined with information from other sources. Table 5 provides a tentative ranking of the three methods in relation to these four issues, which are then discussed in turn.

Diversity

Formally, the issue of diversity is concerned with sampling bias, and can be dealt with by selecting at random a sufficiently large sample of individual leavers or groups for interview. In practice, it is less important that the sample is statistically representative than that it adequately covers the main types of users, and quota sampling will often suffice. Minimum sample sizes can most cheaply be obtained through structured individual interviews. Sample bias will nevertheless be present, because of non-response among particular types of leaver, and this is why routine collection of data as part of the exit process (as discussed in the previous section) is more reliable.

The nonresponse problem can in part be addressed by relying on information from staff or other group members, rather than leavers themselves. But this raises additional problems. These are illustrated by Table 6, which is based on the sample
Table 6. Main reasons for exit according to different sources (%)

<table>
<thead>
<tr>
<th>Reasons</th>
<th>Members of VB in open mtg.</th>
<th>Leavers interviewed in open mtg.</th>
<th>Loan officers in interview</th>
<th>Leavers in private interview</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resting, temporary or possible rejoinder</td>
<td>18</td>
<td>19</td>
<td>12</td>
<td>10</td>
</tr>
<tr>
<td>Ejected by group for defaulting</td>
<td>49</td>
<td>52</td>
<td>55</td>
<td>14</td>
</tr>
<tr>
<td>Problems with VB or loan officer</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>28</td>
</tr>
<tr>
<td>Personal problems (e.g. illness, death)</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>14</td>
</tr>
<tr>
<td>Death of Member</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Household problems (e.g. marital conflict)</td>
<td>10</td>
<td>7</td>
<td>3</td>
<td>19</td>
</tr>
<tr>
<td>Business problems (e.g. low profit)</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>Positive reasons (don’t need more loans)</td>
<td>2</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Ran away with VB money</td>
<td>3</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>No reason or not known</td>
<td>9</td>
<td>12</td>
<td>24</td>
<td>5</td>
</tr>
<tr>
<td>Total (percent)</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Total (number of observations)</td>
<td>131</td>
<td>58</td>
<td>58</td>
<td>58</td>
</tr>
</tbody>
</table>
described in Table 4 but reveals the prime explanation for exit based on post-interview sorting of unprompted responses. In order to explore potential problems of bias the question was repeated for different groups of respondents. The first column of data shows the explanations for exit provided jointly by village bank members at one of their routine meetings. This refers to all 131 members who exited between the previous two cycles. The second column displays the results for the 58 leavers whom the researcher also succeeded in interviewing personally. A reasonable ex ante assumption would be that it would be harder to interview those that the group claimed to eject for defaulting, but this was not the case. Neither do explanations for exit offered by village bank members and their loan officer differ much—except that the former appeared more confident in identifying members they thought likely to be resting.

In contrast, the last column indicates that the exiting members themselves often differed from remaining users in their explanation for leaving. First, more cited personal, household or business difficulties as the main reason for exit—reasons often hidden from the loan officer and even other members. Second, they identified disagreements over management of the village bank or with the loan officer as the prime reason for exiting.

Depth

Where resources are scarce, the need to ensure depth, detail, and quality of responses from leavers may compete with the need to ensure adequate breadth, thereby raising competing pressures. With a fixed budget, diversity points towards ensuring a larger sample size by using a shorter questionnaire with less experienced interviewers. But the information thereby obtained about each respondent will be much more limited. An in-depth case study should provide a fuller account of the sequence of events that caused someone to leave, but fewer can be completed. One option is to combine a large survey using a very short survey of staff and group members, with in-depth
case studies of a small sub-sample. Another is to select a quota sample for each predetermined user type, and then carry out a small number of short case-study interviews using a semi-structured questionnaire. This approach is discussed further in Copestake, Johnson, & Wright (2002).

It is also challenging to obtain both diverse and detailed views through focus groups. Trust is needed among participants if they are to be open and honest about their differing experiences in each other's presence. Yet village banks are often riven with internal conflict that even highly skilled facilitators will struggle to reveal and manage (Marr, 2002). Where this is the case, members need to be broken into self-selecting sub-groups, but this adds to the time required. If such problems are ignored, focus group discussions and associated participatory exercises may generate information that is either sanitised or reflects the view of a dominant minority.

Inclusive Learning

A potential strength of the focus group approach is that it can foster more inclusive learning among both participating users and staff. A rise in exit rates may indeed be a symptom of internal conflict, and some of it may be unavoidable, but it may also be partially generated by lack of communication and dialogue, or by a break down in relations with staff. Copestake (2002a), for example, suggests that village banks may undergo a transition crisis after three or four loan cycles, which may be exacerbated by rapid staff turnover and increased repayment problems as loan sizes increase. However, maximizing the potential for group discussion to contribute to improved mutual understanding and conflict resolution is not easy and requires skilled and often expensive facilitation.

Individual interviews may also be a useful learning experience for users, though they obviously also make demands on users' time. The case for using staff as interviewers is more problematic. In-depth case study interviews require probing and recording skills as well as a degree of detachment which junior staff are unlikely to have. They can be more easily
trained to carry out prestructured interviews, and possible bias can be reduced by using staff from one area to interview in another. ODEF, for example, has found this an effective mechanism for staff learning and cross-fertilisation of ideas—so much so that they have encouraged other MFOs in Honduras to do the same (Copestake, 2002b).

Additionality
A final issue bearing on choice of method is the extent to which information can be combined and jointly analyzed with data from other sources. There are several distinct aspects to this. First, there is the question (already discussed in the last section) of the extent to which data can be merged to create a single larger database. By merging exit and entry data for the same sample of users, for example, it is possible to analyze the question of who leaves in more depth. Second, to the extent that the same method is repeated and/or replicated in several areas, there is more scope for comparative analysis. For example, in the Honduran case cited above, the involvement of an umbrella organization made it possible to produce confidential data about exit rates for each participating MFO and also aggregate findings for the whole sector. Third, use of more than one method can be complementary. For example, the sample survey may provide breadth and an indication of the relative importance of different reasons for exit, while in-depth interviews clarify lines of causation. Finally, overlapping findings based on differences permit cross checks for consistency and avenues for further investigation. For example, independent rankings of reasons for exit by staff and user groups may highlight important differences in their points of view (see below).

Framing and Analysis of Questions.
Even when interviewed alone, users may be reticent about giving the full story of why they left for many reasons. They may feel bad about admitting that their business has failed, or that they experienced problems as a direct result of breaking an
Table 7. Reasons for exit from rural and urban areas of Malawi.

<table>
<thead>
<tr>
<th>Exogenous factors</th>
<th>Rural Branch</th>
<th>Urban Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
</tr>
<tr>
<td>Business performing poorly</td>
<td>129</td>
<td>32.1</td>
</tr>
<tr>
<td>Transferred to another area</td>
<td>60</td>
<td>14.9</td>
</tr>
<tr>
<td>Pressure from spouse</td>
<td>34</td>
<td>8.5</td>
</tr>
<tr>
<td>Would like to take a break for a cycle</td>
<td>27</td>
<td>6.7</td>
</tr>
<tr>
<td>Illness (self or family member)</td>
<td>24</td>
<td>6.0</td>
</tr>
<tr>
<td>Obtained formal employment</td>
<td>15</td>
<td>3.7</td>
</tr>
<tr>
<td>Needed access to savings</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Death</td>
<td>1</td>
<td>0.2</td>
</tr>
<tr>
<td>Subtotal</td>
<td>290</td>
<td>72.1</td>
</tr>
</tbody>
</table>

| Factors potentially within bank control       | Rural Branch | Urban Branch |
|                                               | No.   | %    | No.   | %    |
| Not guaranteed by others                      | 21    | 5.2  | 67    | 12.6 |
| Loan default                                  | 32    | 8.0  | 75    | 14.1 |
| Missed loan repayment                         | 1     | 0.2  | 38    | 7.1  |
| Misuse of VB funds                            | 0     | 0.0  | 6     | 1.1  |
| Poor attendance or late for meetings          | 11    | 2.7  | 6     | 1.1  |
| Savings below the required amount             | 4     | 1.0  | 4     | 0.8  |
| Obtained loan from other agency               | 4     | 1.0  | 29    | 5.5  |
| Needed a bigger loan                          | 11    | 2.7  | 8     | 1.5  |
| Dissatisfied with methodology                 | 25    | 6.2  | 19    | 3.6  |
| VB meetings are inconvenient                  | 3     | 0.7  | 3     | 0.6  |
| Subtotal                                      | 112   | 27.9 | 255   | 47.9 |
| Total                                         | 402   | 100  | 532   | 100  |

For more details of this study see Copestake et. al (2002).
MFO's policies with respect to loan utilization, for example. Asking the direct question "why did you leave the program" rarely results in accurate information, nor exposes the underlying reasons for exit, particularly if the questioner is a member of staff. Simanowitz (personal communication) reports that when SEF in South Africa started exit surveys the standard responses were usually that leavers were "resting" or had "family problems" or "got a job." In many cases, these reasons were symptomatic of deeper problems, linked to the way program participation changed power relations within the family, or to financial difficulties (and associated shame) arising from business failure. Only with patience and growing trust (borne in part of a clear understanding of how information will and will not be used) can these problems be overcome. Extensive piloting of questions is essential, as is careful training of interviewers. And particular care is needed when questions have to be translated and when there are significant sociocultural differences between interviewers and respondents (Wright, 2002).

The discussion in the previous section highlights that the way questions are framed is important for another reason. The

<table>
<thead>
<tr>
<th>Enter one or two comments for each row.</th>
<th>Personal</th>
<th>Business or Livelihood</th>
<th>Group or Staff</th>
<th>Nature of the Product</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underlying problem(s)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributory factor(s)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&quot;Last straw&quot; or trigger(s)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 8. Suggested framework for classification of reasons for exit.
more questions are fixed in advance, the greater the danger of failing to pick up unexpected facts, but the easier and quicker is subsequent analysis (Moris & Copestake, 1993). One compromise is to allow respondents to offer their own reasons for leaving, but then classify them into broad predetermined categories. Table 7 illustrates with data from FINCA Malawi based on standard exit forms filled in by loan officers prior to authorising the release of savings belonging to members wishing to leave. The form was designed to identify the extent to which exit could be attributed primarily to factors within or beyond the control of the organization itself. It reveals that exit in rural areas arose more for exogenous reasons whereas exit in urban areas could be attributed more to factors internal to the service itself.12

An obvious weakness of this data, as well as that produced in Table 6, is that exit of each individual is attributed solely to a single prime cause which is always a simplification (Hulme, 1999; Sebstd, Neill, Barnes, & Chen, 1995). Table 8 suggests an alternative framework for classifying reasons for exit that would permit more sensitive analysis without being overly complicated. Interviewers could ask respondents to list the problems they faced, then write them on small cards and discuss with them where each should be placed in the matrix. The same issue of how to classify data arises from focus group discussions. Exercises such as ranking of reasons for exit yield a great deal of information which may be of immediate use for participants, but which is not easily summarized or compared with similar data collected from other groups. To overcome this problem some method of scoring is needed, ideally a method that is itself agreed on by concerned stakeholders.

Table 9 illustrates the point by presenting summary data obtained from ranking unprompted explanations for exit collected from 16 focus group discussions covering staff and users of three MFOs in Zambia. The original data was hard to
Table 9: Reasons for exit advanced at focus group discussion in Zambia

<table>
<thead>
<tr>
<th>Business related issues</th>
<th>User Groups (11)</th>
<th>Staff Groups (5)</th>
<th>Overall (16)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan use reallocation (misuse)</td>
<td>6 33</td>
<td>3 25</td>
<td>9 58</td>
</tr>
<tr>
<td>Business failure</td>
<td>4 33</td>
<td>2 15</td>
<td>6 48</td>
</tr>
<tr>
<td>Poor economic environment</td>
<td>2 18</td>
<td>3 25</td>
<td>5 43</td>
</tr>
<tr>
<td>Changing line of business</td>
<td>3 15</td>
<td>0 0</td>
<td>3 15</td>
</tr>
<tr>
<td>Competition from other MFOs</td>
<td>1 4</td>
<td>2 10</td>
<td>3 14</td>
</tr>
<tr>
<td>Using loan to start business</td>
<td>2 11</td>
<td>0 0</td>
<td>2 11</td>
</tr>
<tr>
<td>Poor business</td>
<td>1 10</td>
<td>0 0</td>
<td>1 10</td>
</tr>
<tr>
<td>Lack of market</td>
<td>1 8</td>
<td>0 0</td>
<td>1 8</td>
</tr>
<tr>
<td>Cross border businesses</td>
<td>1 7</td>
<td>0 0</td>
<td>1 7</td>
</tr>
<tr>
<td>Multiple borrowing</td>
<td>1 5</td>
<td>0 0</td>
<td>1 5</td>
</tr>
<tr>
<td>Sinking working capital in assets</td>
<td>1 4</td>
<td>0 0</td>
<td>1 4</td>
</tr>
<tr>
<td>Change of location</td>
<td>0 0</td>
<td>1 3</td>
<td>1 3</td>
</tr>
<tr>
<td>Financial needs are met</td>
<td>0 0</td>
<td>1 2</td>
<td>1 2</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>23 148</strong></td>
<td><strong>12 80</strong></td>
<td><strong>35 228</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Individual/family issues</th>
<th>User Groups (11)</th>
<th>Staff Groups (5)</th>
<th>Overall (16)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of understanding</td>
<td>2 18</td>
<td>0 0</td>
<td>2 18</td>
</tr>
<tr>
<td>Death in the family</td>
<td>1 4</td>
<td>3 12</td>
<td>4 16</td>
</tr>
<tr>
<td>Poor attitude</td>
<td>0 0</td>
<td>1 11</td>
<td>1 11</td>
</tr>
<tr>
<td>Illness and death in the family</td>
<td>1 4</td>
<td>1 5</td>
<td>2 9</td>
</tr>
<tr>
<td>Discouragement from husband</td>
<td>1 6</td>
<td>0 0</td>
<td>1 6</td>
</tr>
<tr>
<td>Illness (relative)</td>
<td>0 0</td>
<td>1 5</td>
<td>1 5</td>
</tr>
<tr>
<td>School fees</td>
<td>1 5</td>
<td>0 0</td>
<td>1 5</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>6 37</strong></td>
<td><strong>6 33</strong></td>
<td><strong>12 70</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Staff/group issues</th>
<th>User Groups (11)</th>
<th>Staff Groups (5)</th>
<th>Overall (16)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group size</td>
<td>4 31</td>
<td>1 8</td>
<td>5 39</td>
</tr>
<tr>
<td>Defaulters</td>
<td>2 17</td>
<td>0 0</td>
<td>2 17</td>
</tr>
<tr>
<td>Staff inexperience</td>
<td>0 0</td>
<td>1 10</td>
<td>1 10</td>
</tr>
<tr>
<td>Group misunderstanding</td>
<td>1 3</td>
<td>1 6</td>
<td>2 9</td>
</tr>
<tr>
<td>Recruiting unknown partners</td>
<td>1 9</td>
<td>0 0</td>
<td>1 9</td>
</tr>
<tr>
<td>Lapse in implementation</td>
<td>0 0</td>
<td>1 9</td>
<td>1 9</td>
</tr>
<tr>
<td>Dishonesty of staff</td>
<td>1 3</td>
<td>0 0</td>
<td>1 3</td>
</tr>
<tr>
<td>Poor supervision by credit officer</td>
<td>1 3</td>
<td>0 0</td>
<td>1 3</td>
</tr>
<tr>
<td>Family members in same group</td>
<td>0 0</td>
<td>1 1</td>
<td>1 1</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>10 66</strong></td>
<td><strong>5 34</strong></td>
<td><strong>15 100</strong></td>
</tr>
</tbody>
</table>

"Count" indicates the number of groups citing a particular explanation and "score" indicates the above according to the way each group ranked the explanation: 11 for most important, down to 1 for the 11th most important, except in the summary section, where "count" is the percentage share of the total number of explanations advanced by all groups and "score" is the percentage share of total explanations weighted according to how they were ranked. For the source data see Musona and Coetzee (2001).
Table 9 cont’d

<table>
<thead>
<tr>
<th>Product design issues</th>
<th>User Groups</th>
<th>Staff Groups</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weekly repayment too rigid</td>
<td>7</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Loan insurance fund</td>
<td>10</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>Group liability</td>
<td>5</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Loan disbursement (delays)</td>
<td>8</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>Loan amount</td>
<td>4</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>High interest rate</td>
<td>3</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Requirement to work in groups</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Lock-in system (lack of respect)</td>
<td>3</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Grace period lacking</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Group repayment</td>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Weekly meetings</td>
<td>1</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Repayment period</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Savings precondition</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Changes of loan conditions</td>
<td>1</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>Refusal to accept prepayment</td>
<td>1</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Fear of loss of collateral</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Loan disbursement fees</td>
<td>1</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Late fees</td>
<td>1</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Share contribution</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Bonus</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Meetings take to long</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Totals</td>
<td>55</td>
<td>414</td>
<td>76</td>
</tr>
</tbody>
</table>

Summary of focus group explanations for exit.

| Business context                             | 24          | 22           | 25      |
| Individual/family                            | 6           | 6            | 9       |
| Staff/group relations                        | 11          | 10           | 11      |
| Product design/terms                         | 59          | 62           | 55      |
analyze in its crude form, since each group ranked a different set and number of explanations. Once the data is pooled, the simplest approach is to count the frequency with which each explanation was cited, regardless of the ranking. A second approach takes rankings into account by giving each a standard score (11 for top rank, 10 for 2nd and so on) which can then be added together for each group. The last panel shows the percentage distribution of these counts and scores falling under each of four generic categories. This then provides a format through which data from exit surveys from different sources can easily be compared.

4. Conclusions

This paper has argued first that exit monitoring is an important task for all MFOs seeking to improve the quality of the services that they provide, in pursuit of both commercial and social goals. Exit rates have the advantage that they can be unambiguously defined, and effective monitoring of reasons for exit may help an MFO to identify and address otherwise commercially damaging problems. It also reduces the public policy argument for investing in other forms of impact assessment. The paper has also argued that there is scope for improving the quality of exit monitoring.

First, more work is required than often assumed to ensure that published exit rates are strictly comparable. More specifically, an exit rate should specify the interval or time period, the service being declined and the population frame covered. Ideally, some effort should be made to distinguish between temporary and permanent exit, as well as exit that reflects bad experiences and middling-to-good.

Second, there is scope for collecting and monitoring more exit information routinely, particularly where simple questions can be asked of all or most leavers and analyzed in conjunction with other data stored within the MFO's management information system. This in turn permits the MFO to monitor how exit rates vary for different types of user, and how they
change as users, their businesses, user groups, branches, and the organization itself changes over time.

Third, a mixture of sample surveys, focus group discussions, and in-depth case studies can be used to collect more detailed information about why different types of user leave. Choice of methods depends on many factors, including the need to ensure both breadth and depth of understanding, the scope for building exit studies into staff and group development, and the possible benefits of analysing the data in combination with data from other sources.

Finally, it has been argued that data can be collected using questions that produce more realistic answers yet are still amenable to relatively straightforward statistical analysis. More systematic presentation of statistics can help senior staff to compare performance between types of users, branches, and staff within a single organization. It would also permit franchising and umbrella organizations to aggregate statistics, and even compare performance between members.

References


Journal of Microfinance


Notes

Comments on this paper are welcome and should be sent by email to j.g.copesstake@bath.ac.uk. The paper has been written as part of the Imp-Act programme, supported by the Ford Foundation. Imp-Act stands for "Improving the impact of microfinance on poverty: an action research project." For more information www.Imp-Act.org. An earlier version of this paper was presented at a conference on "Finance and Development" at IDPM Manchester in 2001. I am grateful to participants as well as Anton Simanowitz, Mark Schreiner, Susan Johnson, and Katie Wright for comments. Thanks are also due to Sheena Carey and to Gibson Masumbu for help in collecting and analysing the data reproduced in Tables 5, 6, and 7.

1. For more discussion see, for example, Woller (2002), Simonawitz (2000) and Copesstake (2000).

2. This definition corresponds to the fourth formula reviewed by Rosenberg (2000, 26) which can be written more clearly as $E = (AC\text{end} - NC) / (AC\text{begin})$. 

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where ACend is the number of active users at time T, NC is new users and ACbegin is the number of active users at time T + 1.

3. Village banking organizations are a subgroup of MFOs that operate through semiautonomous groups that have their own bank accounts. A village banking organization receives a single loan for which its members are collectively liable rather than acting solely as a conduit for individual loans from the sponsoring organization to its members. Primary groups may be urban as well as rural and referred to as self-help groups, trust banks, or communal banks as well as village banks. Hatch et. al (1989) provide a fuller description of the village bank model as developed by FINCA. Woller (2000) provides a statistical review of the financial performance of village banking organizations compared to other types of MFO, and Painter (1999) provides an unusual example of an attempt to systematically compare exit across a sample of seven different village banking organizations. Retention rates (defined as the proportion of first-cycle borrowers still active into a third year of operation) ranged from 23 to 83%.

4. Indeed, there may be a direct trade-off between loan cycle intervals and exit rates. This is because delay may permit late repayment by village bank members. Other members might otherwise have been forced to cover these debts, and hence they are even more inclined to expel those in arrears.

5. This suggests that using shorter time periods provides better information. However, if the period is short relative to the length of a particular financial contract then most users are retained automatically and a seemingly high retention rate can be misleading. For this reason there is a case for defining retention rates as the number of new contracts issued in a period as a percentage of the number of contracts terminated in the same period, even though this opens up the possibility that the rate may then exceed 100 percent. This is the Waterfield/CGAP formula preferred by Rosenberg (2000, 25). Its disadvantages are that it is intuitively less clear (e.g., the rate may exceed 100 percent) and the source data is less likely to be routinely recorded.

6. In the case of savings and deposit services, measurement is further complicated by the problem of dormant accounts, which hold only small sums and from which no deposits or withdrawals are made for long periods. Yet the very existence of savings may be important as a form of security, as is the option to take up credit even if it is not used.

7. For a comprehensive review of the relevant theoretical literature on this, see the volume edited by Bardhan (1999), particularly the paper by Conlin.


9. For a case study of the negative political repercussions of high exit rates, see Rhynie (2001). Note also Hirschman's (1970) celebrated observation that if
the most articulate users are also the first to exit then this weakens internal "voice" and hence reduces pressures on the organization to improve service quality.

10. This is particularly apposite given that there has been some debate about their long-term financial self-sustainability compared with MFOs that concentrate on providing services direct to individuals or smaller solidarity groups. See Holt (1994) and Woller (2000).

11. Painter (1999) confirms the existence of alternative growth paths by failing to find a clear correlation across seven village banking organizations between exit rates and growth of average loan size. An example of high exit rates being associated with loan screening is provided by Copestake, Bhalotra, and Johnson (2001).

12. Products are required both to retain the more dynamic members who might otherwise graduate to microfinance organizations that offer individual loans, and to enhance users’ debt capacity. For example, Painter (1999, 113) concluded that the following changes were most likely to reduce exit rates: better orientation and follow-up, reduced frequency of meetings and repayment instalments, more tolerance of irregular borrowing, and improved access to savings. Natilson (2000) of Pro Mujer in Bolivia provides another example. She concluded that exit rates could be reduced most effectively by increasing the efficiency of group meetings, raising the maximum loan size, and revising the savings requirements.

13. It is not clear how indirect impacts on nonusers, including other household members, should be taken into account. Presumably this is subsumed under quality. See the Imp-Act website for more discussion of such "wider impacts".

14. For example, there is already strong evidence to suggest that households dependent upon a single earner find it more difficult to cope with personal or business shocks and hence are more prone to getting into arrears and ultimately being forced to exit. See, for example, Copestake et. al (2001b). Pioneering work on “exit rating” as well as credit rating, using large databases from Bolivian MFOs, has been carried out by Mark Schreiner, Director of Research for the Center of Social Development at Ohio State University.

15. There is of course a vast general literature about all of these methods. For a general survey of their use in microfinance impact assessment see Simanowitz (2001, #733). A protocol for an exit survey is the second of the SEEP/AIMS tools (USAID, 2000). On the use of focus group and participatory methods see www.MicroSave-Africa.com. On the in-depth case study see Copestake et. al (2002)
16. By quota sampling, I mean interviewing a minimum number of people belonging to each category of user. For more discussion see Copestake (2001).

17. Even exit surveys will tend to miss those who leave without claiming residual savings or do not have any because they have defaulted, though the frequency of this category of leavers can still be monitored. Where surveys are based on follow-up meetings then data is likely to be biased against those who for whatever reason (probably negative) disassociate themselves most completely from the MFO.

18. For example, SEF in South Africa combine group interviews with up to six follow-up individual interviews. The initial meeting requires 60-90 minutes, and follow-up interviews 30-60 minutes each. Assistant zone managers (and sometimes branch managers) were responsible for the work. Although time-consuming, it fitted in well with their responsibility for monitoring performance and increased their general understanding of programme impact.

19. Painter (1999, 112) reports that discussion groups within their selected sample of seven village banking organizations produced a list of seven main reasons for default. These were: expulsion by others due to delinquency or default (especially during the first three cycles when exit rates were highest), seasonality, migration, poor market conditions, dissatisfaction with weekly repayments, and meetings, inability to access savings without exiting and illness.
To Pay or Not to Pay?

Local Institutional Differences and the Viability of Rural Credit in Nicaragua

by Johan Bastiaensen
Ben D’Exelle

Abstract: Innovative credit enterprises, aiming to expand the frontier of the rural credit market, can attain financial sustainability and broadened social outreach if they embed financial operations in local institutions, such as social networks and prevailing rules. Only in this way can the "rules of the game" imposed by the credit enterprise gain the local legitimacy that is necessary to reduce transaction costs sufficiently. The nature of preexisting local institutional environments, therefore, has a profound effect on the performance of credit enterprises. Our analysis of a rural microcredit program in two neighboring villages in Nicaragua indicates that existing patron-client structures, conditioned by Sandinista agrarian reform and the harshness of agro-ecological conditions, had a negative effect on the local acceptance of strict repayment rules. This analysis suggests that the evaluation of credit enterprise performance should take into account differences in local institutional environments and that efforts should be made to fine-tune standard financial technology to more adverse institutional conditions. If not, the microfinance industry may tend to exclude more difficult and poorer rural areas.
Introduction

It is customary to frame the challenge of expanding the rural credit market frontier as primarily an issue of adopting appropriate financial technologies (Yaron, Benjamin, & Priepke, 1997). On the one hand, sound financial and business management practices are emphasized. Without such practices, it is indeed not possible to operate a sustainable financial enterprise that is capable of serving a broad social spectrum of clients without massive subsidies. On the other hand, the recommendations stress the need to implement adequate transaction-cost-reducing mechanisms. Costs relating to client selection and the specification and enforcement of financial contracts are relatively fixed per credit transaction and therefore evolve disproportionately to loan volumes. Inevitably, financial operations with poorer clients tend to entail higher transaction costs per unit of loan volume (Barham, Boucher, & Carter, 1996). To avert the danger of transaction cost rationing, a system of conditional loan renewal and a variety of recommendation and locally pooled information mechanisms, such as group credit schemes, are commonly recommended. These evidently need to be embedded in an appropriate and location-specific social interface with the local client community in order to create adequate repayment incentives and sustain the local legitimacy of the financial rules of the game.

Some versions of microcredit advocacy, such as that of the "intermediary school," assert that the entrepreneurial success of the credit system in itself indicates the positive development impact of microcredit and other financial market-enhancing systems (Yaron, et al., in Hulme, 2000, p. 82). It is assumed that the ability to do sustainable financial business with previously excluded clients constitutes an unequivocal indicator that a previously uncovered segment of solvent demand is met.

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by the extended supply of the financial system. However, the extension of a sustainable credit supply does not automatically imply that access has been extended in an optimal manner to all the relevant groups. Therefore, several recent studies argue that more refined questions need to be raised about the quality of the fit between supply and demand (Hulme, 2000; Morduch, 2000).

Transaction-cost problems in particular create tension between financial sustainability and the broadening of the social coverage of the credit supply (Rhyne, 1998; Morduch, 2000). The extended credit supply apparently tends to become concentrated on the upper-poor segments of the potential client population in urban and, to a much lesser extent, the less adverse rural areas (Hulme & Mosley, 1996). In the more adverse and poorer rural areas, the construction of an appropriate social interface between the credit system and the client community turns out to be particularly burdensome. This generates an incentive for the credit systems not to cover these problematic rural areas, especially if they give priority to the rapid attainment of strong financial sustainability, as the received "best practice" wisdom requires.

By comparing the relative success and failure of an initiating rural credit program in two neighboring rural villages in Nicaragua, this article explores some of the local institutional factors at play when a credit enterprise tries to create an appropriate social interface with rural client communities. The analysis highlights the need for an initiating microfinance system to take into account the specific "socio-cultural soil conditions," to use a phrase coined by Klitgaard (1994). The nature of the established local institutional environment, defined for our purpose as the whole of the local social structure and its associated rules and norms, plays a vital role in the governance of financial operations. The analysis will also indicate that credit is often not the most pressing constraint on rural livelihoods and that competing access to financial resources can lead clients and communities to prefer other types of relations,
both inside and outside the local community, above their (future) relation with the credit enterprise.

The following sections analyze the institutional environment of the two villages, as well as the comparative experience and results of the credit program under study. Subsequently, we will reflect on the causes of the clear differences in performance of the credit enterprise. Finally, we will derive some conclusions about rural finance and differential local institutional environments.

The Experience of the FDL in Two Neighboring Yet Distinct Villages

Our analysis concerns the experience of the “Fondo de Desarrollo Local” (FDL) in two neighboring villages in Masaya, a rural peri-urban region in Nicaragua, some 40 km south of the capital Managua. Today, the FDL is one of the largest and definitely the most rural of all alternative credit institutions in Nicaragua, serving about 13,500 clients with a portfolio equivalent to 13 million USS (FDL, 2002). About 50% of these clients live in rural areas across the country. The FDL is one of the 25 microfinance institutions trying to fill the gap in the financial markets created by radical liberalization and the withdrawal of the state development bank BANADES (Jonakin & Enríquez, 1999). However, in this article we will not deal with its present-day success, but rather concentrate on the problems it encountered during the initial phase in the early 1990s. At that time, the FDL found itself on the steep slope of the learning curve and much of its management and financial technology was still experimental and adaptive.

The present analysis focuses on the experiences of the FDL in two villages belonging to the same region. In the first village, Los Angeles, the FDL was ultimately successful in establishing a workable social interface with the clients, so that operations expanded impressively. In the second village, San Rogelio, the FDL was unable to establish such an interface and eventually had to withdraw.
The Institutional Environment in the Two Villages

Agroecological and Economic Characteristics

The rural communities of San Rogelio and Los Angeles are situated in the northern plains of Masaya, in the Pacific region of Nicaragua. Because of its proximity to the capital and other important cities, the region has a reasonably developed road infrastructure and good access to urban markets. Thus, both villages have great economic potential.

The first village, San Rogelio, has an area of 13 sq. km and a population of 240 households, resulting in a population density of 93 habitants per sq. km. Two-thirds of the households received land during the Sandinista agrarian reform and, therefore, became members of one of the 11 established production cooperatives. In total, 640 hectares were redistributed, amounting to an average of four hectares per household. It is important to note that about a third of the present-day population immigrated during the land reform period. Historically, San Rogelio was a poorly populated area dominated by extensive cattle estates. The antecedents of both the original population and the land reform migrants are therefore predominantly rural wage laborers.

Access to San Rogelio is relatively difficult, because infrequent public transport passes along a poorly maintained sandy road. In Los Angeles, on the other hand, an all-weather tarmac road and regular public transportation services guarantee all-time access to the nearby urban markets. With 550 households living in an area of 10 sq. km, Los Angeles has a population density of 275 people per sq. km, three times higher than San Rogelio. The agrarian reform established eight production cooperatives that benefited 93 households (about 17% of the present-day population). Agrarian reform beneficiaries in Los Angeles received, on average, smaller plots of land: about 2.3 hectares per household, for a total of 216 redistributed hectares in the village (Barrios y Gómez, 1992). Furthermore, many of the agrarian reform beneficiaries were already living in the community before the reform was implemented. Immigration
prompted by the land reform was almost nonexistent. Many of the agrarian reform beneficiaries previously owned small plots of land and therefore had prior experience as peasant producers.

On average, households in San Rogelio also own more land than those of Los Angeles. However, this advantage is counterbalanced by somewhat more adverse agroecological conditions (less fertile soils and more irregular rainfall) and by the lack of previous experience as independent peasant producers. This results in a lower productivity per hectare compared with that of Los Angeles.

Table 1. Los Angeles and San Rogelio: basic indicators

<table>
<thead>
<tr>
<th></th>
<th>Los Angeles</th>
<th>San Rogelio</th>
<th>Pearson Chi-square</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of observations</td>
<td>45</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Landownership in hectares (mean per household)</td>
<td>1.48</td>
<td>2.85</td>
<td>1.669**</td>
</tr>
<tr>
<td>Landowning households</td>
<td>46%</td>
<td>60%</td>
<td>1.321</td>
</tr>
<tr>
<td>Households with a negative perception of recent economic evolution</td>
<td>24%</td>
<td>67%</td>
<td>13.224**</td>
</tr>
<tr>
<td>Households with access to credit</td>
<td>43%</td>
<td>73%</td>
<td>6.583*</td>
</tr>
<tr>
<td>Households attended by a development project</td>
<td>46%</td>
<td>93%</td>
<td>17.860**</td>
</tr>
</tbody>
</table>

Source. Survey, December 1999; data refer to households. A T-test was used. For all other variables, the Chi-square test was used since they are of a categorical type.

* Significant at the 5% level
** Significant at the 1% level
At the same time, the poorer accessibility of San Rogelio implies more limited nonagricultural economic opportunities. Observation in the field indicates unequivocally that self-employment activities in Los Angeles are more diversified, including artisanal activities, services, and petty commerce besides agriculture. Although no attempt has been made to collect data on family incomes in the two communities, there are also strong indications that the average family income in San Rogelio is slightly lower than that in Los Angeles. In dynamic terms, the perception of the recent economic evolution is significantly more negative in San Rogelio, where 67% of the interviewees said their individual economic situation has evolved negatively, compared with only 24% in Los Angeles (see Table 1). At the same time, significantly more people have access to credit and development organizations in San Rogelio. So far, however, this stronger presence of development projects does not appear to have sufficed to reverse adverse economic trends.

The Incidence of the Agrarian Reform

Before exploring further institutional differences between the two communities, it is important to comment more extensively on the Sandinista agrarian reform, and in particular on the origin and evolution of the cooperative structures. After all, this agrarian reform was identified as one of the crucial determinants of the present constellation of the institutional environment of both villages.

The agrarian reform implemented by the Sandinista government in the 1980s has had a heavy, albeit unequal, impact on the agrarian structure and the institutional dimension of San Rogelio and Los Angeles. Although more than a decade has now passed since the agrarian reform, its influence in both communities remains evident. Because of the much broader incidence of agrarian reform in San Rogelio, this community exhibits a much more pronounced presence of agrarian reform
cooperative structures and the culture associated with these social structures.

As elsewhere in Nicaragua, the agrarian reform conditioned land transfers in the region upon the formation of production cooperatives with collective title and production. Very often, production cooperatives were formed by landless people, more or less accidentally grouped together by Sandinista mass organizations that tried to meet individuals' demands for land from the available estates. Because of the nature of this process, there was little space for organic and spontaneous organization processes within the cooperatives. Moreover, these cooperatives were rather vertically governed by the Sandinista state, with the local directives of the cooperatives serving as intermediaries towards the members. The members hardly possessed any autonomy with respect to production decisions, but this was compensated by the almost complete absorption of the risk by the cooperative (fixed salaries) and the state (remission of debts and free access to education and health as compensation for the artificially low production prices).

Consequently, the members enjoyed a guaranteed minimum subsistence level independent of production results. As Ruben (1997) asserts, the "cooperative institution" in this sense shows a certain resemblance to the "sharecropping institution," where the tenant and the landlord divide production risks, although the Sandinista state went much further than the average landlord in absorbing risks and guaranteeing minimum incomes. As a mechanism, this guarantee may be considered similar to the minimum survival guarantee in the "moral economy of the peasant" (Scott, 1976), but in this instance, it is provided by a paternalistic, revolutionary state and mediated by the local political leadership that manages the relations with this state.

Partly owing to the overly directive and protective governance of economic activity in the cooperatives, collective production exhibited many problems. Distorted prices and the
availability of abundant, cheap, and easily accessible finance contributed to a highly inefficient use of resources. It also provided ample opportunities for outright abuses by the leaders of the cooperatives. Such abuses and the system of standardized fixed wages caused serious incentive problems, inducing free-riding behavior on the part of cooperative members. Low identification of cooperative members with their cooperatives also resulted in a surprisingly high level of membership rotation. As a consequence of low official prices, production was often not profitable despite huge subsidies for inputs and agricultural machinery. This was, however, resolved by periodically condoning the outstanding debts.

In 1988, the abandonment of the wartime-planned economy, under which the cooperatives had been maintained in disregard of underlying profitability considerations, radically transformed their economic and management context. Distorted prices were rapidly adjusted and access to credit became severely restricted, whereas outstanding debts now had to be honored. Under these conditions, collective capital-intensive production turned out not to be viable. With the 1990 electoral defeat of the Sandinistas, government support and state control disappeared. Forced by internal problems and changing external conditions, practically all production cooperatives had, by the mid-90s, abandoned collective production in favor of land parceling into individual plots (D'Exelle and Bastiaensen, 2000; Vaessen, Cortez, & Ruben, 2000).

Although at the time of research, most production cooperatives no longer formally existed, in several communities, cooperatives' decision-making frameworks remained partially operative in order to manage the process of legalization of the insecure collective land rights into formalized individual land titles. Moreover, for many relations—especially relations with external actors—the old governance structures continued to play a decisive role as an established mechanism of collective action for which little organizational alternative had emerged.
Aspects of the Social Structure

Table 2 shows the consequences of the agrarian reform on the social structure in both villages. On the basis of survey results, we estimate that 32% of the population of San Rogelio was composed of first-generation immigrants, compared with 11% in Los Angeles. At the same time, more than half of the households identified themselves as belonging to a cooperative, while this figure was only 10% in Los Angeles. Taking these data into account, we conclude that the social structure of the San Rogelio community has clearly been more profoundly affected by the agrarian reform.

Moreover, we observe that the San Rogelio community is characterized by a significantly more explicit political allegiance than Los Angeles, with a logical preference for the Sandinista party. The Party continues to be associated with access to land and better times in terms of subsidies and protection. Not surprisingly, then, the Sandinista party obtained victories in this community in the municipal elections of 1992, 1996, and 2000. The UNAG, the peasant union with Sandinista affiliation, also occupies a relatively central position in the community. The Sandinista character of the community also explains why participation in religious activities is significantly lower, since the Catholic Church—the dominant religion in Masaya—is associated with anti-Sandinista networks.

We also observe that the population of the San Rogelio community is significantly better served by external development organizations. Local leadership in this community has a much better intermediation capacity than the leadership of Los Angeles. In San Rogelio, the external linkages with the state and, nowadays, nongovernmental development organizations are almost exclusively mediated by local Sandinista leaders. These leaders have been able to maintain their position as mediators, gained during the revolutionary agrarian reform process. Instead of acting as mediators of the Sandinista state, today they mediate the benefits of external organizations.
Table 2. Some characteristics of the social structure

<table>
<thead>
<tr>
<th></th>
<th>Los Angeles</th>
<th>San Rogelio</th>
<th>Pearson Chi-square</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of observations</td>
<td>45</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Immigrants*</td>
<td>11%</td>
<td>32%</td>
<td>6.818 **</td>
</tr>
<tr>
<td>Cooperative membership</td>
<td>10%</td>
<td>53%</td>
<td>15.286 **</td>
</tr>
<tr>
<td>Explicit political allegiance of family head</td>
<td>38%</td>
<td>77%</td>
<td>10.487 **</td>
</tr>
<tr>
<td>Political preference for the Sandinista Party</td>
<td>19%</td>
<td>47%</td>
<td>6.291 *</td>
</tr>
<tr>
<td>Political preference for the Liberal Party</td>
<td>19%</td>
<td>17%</td>
<td>0.067</td>
</tr>
<tr>
<td>Active religious membership</td>
<td>71%</td>
<td>43%</td>
<td>5.382 *</td>
</tr>
<tr>
<td>Households attended by a development project</td>
<td>46%</td>
<td>93%</td>
<td>17.860 **</td>
</tr>
</tbody>
</table>

Source: Survey, December 1999; data refer to households.

* For this variable the number of observations are respectively 60 and 50; in cases where there were 2 decision-makers per household, both were asked about their origin.
* Significant at the 5% level
** Significant at the 1% level

toward their people, usually with implicitly similar views regarding subsidies and protection against risks.

The social structure of the Los Angeles village is more heterogeneous. Besides agrarian reform beneficiaries, it encompasses a large group of traditional peasants. The UNAG has less influence on communal life and the existent development interventions. Significantly fewer people receive benefits from development programs. Most local leaders were born in the community, and many were active before the agrarian reform.
They may be considered more traditional, historical leaders. The population is less politicized, and there is no significant preponderance of any political party in the community.

A Tentative Assessment of the Quality of Community Life

Another, more indirect way to assess local institutional differences consists in an analysis of the perceptions on the qualitative functioning of relations within the community and with outsiders. We try to measure these perceptions through subjective ratings attributed by the habitants on the basis of questions relating to six dimensions: mutual support, trust, collective action and common interest, leadership, respect for the law, and opinions about external actors.

If we calculate a total perception index based on these questions, we find that it is significantly more positive in the Los Angeles community. For most of the dimensions, we observe a significant difference between the two communities, in favor of Los Angeles, except for the perception of the local leadership, where no significant difference is found. In general terms, this points toward a better overall quality of the institutional environment in Los Angeles, where more people feel protected by mutual solidarity mechanisms; insiders as well as outsiders inspire more trust; the rating of the capacity for mutually beneficial collective action is better; the perception of national and local government is less negative; and both respect for and confidence in the law is higher.

The FDL in the Two Villages

The FDL started its operations in Los Angeles and San Rogelio in 1991. In the initial phase, the program underwent a number of policy changes as it struggled to find appropriate financial technologies and management systems. It started its activities with local banks administrated by the communities themselves. At the time, it was believed that interference with local dynamics on the part of the external development organization had to be minimized and gradually reduced. However, this
Table 3. Perceptions about dimensions of community life and external actors *

<table>
<thead>
<tr>
<th></th>
<th>Los Angeles</th>
<th>San Rogelio</th>
<th>Mann-Whitney U test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of observations a</td>
<td>86</td>
<td>46</td>
<td></td>
</tr>
<tr>
<td>Total index</td>
<td>0.54</td>
<td>0.44</td>
<td>2091.0 **</td>
</tr>
<tr>
<td>Mutual support</td>
<td>0.64</td>
<td>0.55</td>
<td>1575.5 *</td>
</tr>
<tr>
<td>Trust</td>
<td>0.61</td>
<td>0.51</td>
<td>1452.0 **</td>
</tr>
<tr>
<td>Collective action and common interest</td>
<td>0.48</td>
<td>0.35</td>
<td>1505.0 *</td>
</tr>
<tr>
<td>Leadership</td>
<td>0.60</td>
<td>0.57</td>
<td>2925.0</td>
</tr>
<tr>
<td>External interventions</td>
<td>0.44</td>
<td>0.27</td>
<td>2427.5 **</td>
</tr>
<tr>
<td>Respect for the law 0.48</td>
<td>0.38</td>
<td>2625.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Survey, December 1999; data refer to opinions expressed by individual family members.

a. A higher index indicates a more positive perception.
b. The number of observations for these perception variables are higher than those for the variables in both previous tables; in cases where there were 2 decision-makers per household, both were asked about their perception.
c. With only three question per index, indices are not sufficiently continuous. Therefore, a non-parametric Mann-Whitney U test was used to detect significant differences between the two villages.

* Significant at the 5% level ** Significant at the 1% level

... approach was abandoned, since it created persistent and unsustainable default rates.

In 1993, this self-management system was transformed into a comanagement system. The latter allowed a negotiated definition and an ex-post control of clear and objective “rules of the game” by the FDL. A crucial component of these rules was the principle of conditional renewal and expansion of the credit portfolio, both at individual and at village-bank levels.
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Table 4. The FDL in San Rogelio and Los Angeles: Portfolio, number of clients and default rates

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>San Rogelio</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portfolio</td>
<td>US$38,770</td>
<td>US$28,765</td>
<td></td>
<td>Operations ceased</td>
</tr>
<tr>
<td>Number of clients</td>
<td>166</td>
<td>n.a.</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>AR</td>
<td>108</td>
<td>n.a.</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>No-AR</td>
<td>58</td>
<td>n.a.</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Default rate</td>
<td>50%</td>
<td>6.3%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Los Angeles</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portfolio</td>
<td>US$44,24</td>
<td>US$41,410</td>
<td>US$97,433</td>
<td>US$156,286b</td>
</tr>
<tr>
<td>Number of clients</td>
<td>40</td>
<td>92</td>
<td>93</td>
<td>89</td>
</tr>
<tr>
<td>AR</td>
<td>25</td>
<td>50</td>
<td>48</td>
<td>37</td>
</tr>
<tr>
<td>No-AR</td>
<td>15</td>
<td>42</td>
<td>45</td>
<td>52</td>
</tr>
<tr>
<td>Default rate</td>
<td>37%</td>
<td>49%</td>
<td>19%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Sources. Own calculations based on the data system of FDL and LAV; Navarro, Rodriguez & Gómez, 1993. AR = agrarian reform beneficiaries.
a. Default rate is calculated as arrears over expired quotas of credits. n.a. = not available.
b. This figure includes credits extended to 50 clients of other communities that were integrated in the Los Angeles office.

In 1992, the program canalized a portfolio of US$38,770 (see Table 4) toward the community of San Rogelio. Four-fifths of this portfolio was distributed to 68% of the total agrarian reform beneficiaries in the village. Together they represented 65% of all clients of the program in the village. In subsequent years, the program experienced serious recuperation problems, with default rates of around 50%. The program did not succeed in reversing this critical situation. Within the framework of the global shift from self-management to co-management, the FDL intended to reduce local participation in the decision processes, since this was identified as one of the
causes of the low recuperation rate. Effective resistance by the local leadership impeded the implementation of these policy changes. When the FDL decided in 1995 to cancel the injection of new funds, the local “bank” went bankrupt, and it was not able—nor indeed willing—to reestablish relations with the FDL by clearing its outstanding debts, as some other defaulting local “banks” did.

In the Los Angeles community the experience was quite different. As Table 4 shows, in this community the program started its activities with a similarly high percentage of agrarian reform beneficiaries (63% of the clientele). Although the initial phase was a lot less intensive, canalizing only US$4,424 (see Table 4) during the first year, recuperation rates were quite similar to those in San Rogelio. In spite of similar initial problems with the recuperation of credit, the program managed to gradually improve this situation. Several measures to improve the management of credits—such as the reduction of local decision power—could be implemented, and gradually the program augmented its portfolio to over US$ 100,000 in 1998, with a default rate of 8%. By the end of 2001, the program was able to reduce its default rate to a mere 2% (FDL, 2002).

Reflections on the Performance Differences between the Two Villages

With a view to comparing the comparative performances of the FDL and how they relate to the institutional differences between the two villages, details of the local social mechanisms that were mobilized when the FDL tried to embed its operations in the local institutional environments will be given. As indicated, these turned out to be crucial determinants of success or failure.

In San Rogelio, the FDL program established relations with six agrarian reform cooperatives. Unsurprisingly, four of the five elected members on the local credit committee were cooperative presidents. Since, during the Sandinista decade, membership of a cooperative implied an indiscriminate right of
access to credit for all members, it was unimaginable for the local committee to apply any individual selection criteria that could exclude certain problematic individuals from access. Credit was therefore distributed indiscriminately to all members of the selected agrarian reform cooperatives.

After the change of government in 1990, cooperative members saw FDL activities as a simple substitute for credit previously provided by the state rural development bank. They also preserved their perceptions about credit, including its implicit risk management function. Hence, they believed that repayment would not be due in case of adverse income shocks beyond their control. At the same time, cooperative presidents maintained their power positions, since they were almost automatically elected onto the credit committee of the program. They also viewed their new position as a continuation of their previous mediating role toward the Sandinista government. This perception was matched by the dependent clients, who considered it to be the presidents' duty and privilege to negotiate with the FDL on their behalf. Equally, they did not question the arrangement whereby the leadership administered the loan operations without accountability to them. This inherited vertical structure, with its lack of internal transparency and answerability, also resulted in an astonishing, almost absolute ignorance of the rules and the functioning of the bank by its client-members despite FDL's efforts to the contrary.

In 1993, when the village was afflicted by drought, clients expected the credit committee to negotiate a collective remission or at least a restructuring of their debts, as was the custom during the Sandinista period. The persistence of the agrarian reform culture and the presence of high production risks contributed to the persistence of this perception about credit. Moreover, the poor diversification of the local economy and the low presence of informal insurance mechanisms resulted in a high demand for risk sharing with external actors. Not surprisingly, the Sandinista mayor gained wide support during his electoral campaign when he declared that the FDL was not
entitled to claim repayment from the clients in the village. Supported by the UNAG, he even accused the program of dismantling the cooperatives in order to expropriate the land of the members. Furthermore, a newly established welfarist development program reinforced the prevailing populist logic of debt remission and subsidies.

An adequate response by the program to this situation was hampered by the fact that the members of the credit committee, who were also the traditional leaders of the cooperatives, lacked incentives to pressurize for repayment of debts by clients. They had contradictory roles to play, since they were expected both to safeguard the contractual rules of the program and to maintain their power position in the community by mediating resources towards their client networks. Moreover, as indicated, other organizations had now arrived in the community on which they could easily rely to solicit new assistance as a substitute for the FDL.

Caught in the web of patron-client relationships, both leaders and common people preferred the short-term benefits of collectively breaking relations with the FDL to create individual linkages with the FDL-system; they considered the latter to offer little security in terms of future access to additional resources. From the individual client's perspective, this option was, however, fraught with ambiguities, not in the least because many had in fact honored their debts with the FDL. More in particular, the local directors and their close affiliates had accumulated most of the arrears. Given the conditional renewal of loans at village level, a growing realization of this situation triggered a general shift towards nonrepayment that inevitably terminated local FDL operations.

In Los Angeles the experience was different. Although the FDL program entered in a similar way, it successfully changed the credit culture. In spite of identical problems during the start-up years, many clients eventually came to recognize the importance of developing individualized credit records with their "own" local bank. Explanatory variables for this outcome
are their slightly less precarious economic situation, their higher levels of mutual support and solidarity, their larger inclination towards horizontal collective action, and the more positive perception of external interventions in the community. This situation allowed the program to improve its administration and professionalism. In 1993 an evaluation team of the central office observed various improvements in the organization of the program operations (Navarro, Rodriguez, & Gómez, 1993). A difficult learning process was initiated that resulted in a more rigorous selection of individual clients and a better application of the “rules of the game.” In that same year, the program changed the administrative system, moving toward comanagement and reducing the direct local participation in management and day-to-day credit operations. In doing so, the program in Los Angeles was able to improve its performance substantially. It has continued to expand its local operations until today.

Some Tentative Conclusions about Rural Finance and Local Institutional Differences

Analysis of the experience of the FDL program in San Rogelio and Los Angeles indicates that the nature of the local institutional environment has a profound influence on the performance of rural credit programs. The analysis suggests that sustainable credit operations require active participation on the part of local leaders, but at the same time, that some distance needs to be maintained from local networks in order to impose objective “rules of the game” and avoid serving immediate factional interests. The extent to which such a balance can be reached is largely determined by the specific institutional constellation in each particular rural territory. In this particular instance, the institutional environment at village level is related to the relative incidence of Sandinista agrarian reform and its associated social networks and values, as well as to more objective factors, such as the relative levels of poverty and vulnerability.
Of course, as the problems of the self-management period in the FDL indicate, the managerial capacity and the institutional design of the governance structure of external interventions also plays an important part in explaining project performance. Deficiencies in management capacity evidently do not enhance beneficial working relations between credit programs and local clients. Nevertheless, the incidence of initial management errors was identical in the two communities and can therefore not explain the substantial difference in program performance.

Our analysis of San Rogelio indicates that the operation of sustainable credit operations can be severely hampered by the strong influence of patron-client relationships on most of its poor population. This majority is organized in social networks around cooperative and UNAG leaders, who monopolize the linkages with external organizations and are expected to protect and defend their clientele through the mediation of favors. Such patron-client social networks and their associated rules of hierarchy, loyalty, and paternalistic protection cannot easily be made compatible with the rules of a sustainable credit system, including the need to emphasize individual selection procedures and repayment under all conditions.

We do not believe that these problems are typical of Sandinista patron-client relationships, rather that they are characteristic of any type of vertical-authoritarian patronage system. In the case of San Rogelio, however, the problems associated with patron-client practices were aggravated by the previous experience with massive, subsidized, and weakly enforced Sandinista credit, mediated by the very same leadership. In such a context, clients do expect their leadership to negotiate a restructuring or a remittance of pending debts in the case of collective repayment difficulties, as may occur during a drought. However, it should be underlined that the lack of transparency and downward accountability in this institutional setup also contributes negatively to the repayment
culture, owing to the largely unsanctioned opportunism of borrowers in the circles of the "patrons." Clearly, the "Iron Law" of subsidized credit (Gonzalez-Vega, in Krahnen & Schmidt, 1994, p. 19) is at play here. Both factors help to trigger widespread default as well as effective collective action organized by the local leadership against any attempts at individual recuperation of pending debts.

This community contract choice against the safeguarding of long-term relationships with credit programs such as the FDL is also influenced by a number of additional objective factors. In particular, we ascertained that the relatively more pronounced vulnerability and poverty in San Rogelio and the higher incidence of alternative sources of external subsidies likewise play an important role. Both conspire against developing longer-term community relations with sustainable credit systems. Poverty combined with more pronounced climatological and economic vulnerability puts a positive premium on short-term defensive risk mitigation strategies such as those represented by the mediated benefits of the local patrons. The relatively abundant supply of external means from alternative sources, which we can suppose to be a function of both the poverty and the political leverage of the Sandinista leadership, completes the picture, because it allows the leadership to continue mediating short-term mitigating benefits. The option of individual relations with systems like the FDL (based on fixed-price credit contracts) apparently involves too great a risk for poor clients, despite the longer-term opportunities for access to substantial investment resources and growing independence from a contested local leadership. Developing more flexible credit products, possibly with an insurance component, could contribute to counteracting these negative tendencies from the credit programs' viewpoint.

This analysis also raises the question of endogenous institutional choice. Our study indicates that poor, vulnerable
communities might prefer defensive relationships of the "patron-client" type and could thereby become confined to an institutional path that provides short-term risk mitigation, but also involves longer-term disadvantages in terms of economic opportunities and distribution of power. In this process, there may also be an element of complicity on the part of many "welfarist" development organizations, which continue to "assist" the poor in such communities with short-term subsidies, inevitably mediated by local patrons.

For the microfinance industry, this implies that it is much more difficult to work in poor and more vulnerable rural communities. The FDL experience suggests that it is almost impossible to develop sustainable credit operations under the institutional conditions this type of community seems to engender. This, of course, raises important challenges for the poverty-reducing capacity of rural credit systems. In the present context of the industry’s almost obsessive preoccupation with the rapid achievement of financial sustainability, a tendency to concentrate on the geographical areas where institutional conditions are beneficial seems almost unavoidable. Our analysis therefore suggests that microfinance institutions should make a serious effort to search for innovative institutional designs as well as financial products that are more compatible with the needs and opportunities of the local institutional environment. A less stringent, more flexible approach toward credit-delivery to poor and vulnerable communities might be necessary in order to be able to compete successfully with the established protective, yet oppressive, patron-client networks and rules. If such innovative strategies are not given the chance to develop, the microfinance industry will almost inevitably exclude the more difficult social and geographical segments. In doing so, it will not be able to meet its ambitious, self-declared goals of poverty reduction.
References


To Pay or Not to Pay


Appendix: Questions Used to Capture Community Life

A. Mutual support
   1. In this community, when a family faces severe problems, in most cases it cannot count on the support of other families.
   2. In this community people are ungrateful.
   3. In this community it is worthwhile helping people who face problems, as they will then help you should the need arise.

B. Trust
   4. You cannot trust anybody who is not of this community.
   5. In this community, when a person gives his word, he always honors it.
   6. The majority of the people in this community respect the property of others.

C. Collective action and common interest
   7. This community is quite divided.
   8. In case of a crisis (e.g., a drought that affects everyone), people try to discuss and cooperate to find solutions.
   9. There are groups within the community that do not want to have any relation with other groups.

D. Leadership
   10. The leaders work for the good of the community.
   11. People should respect the decisions that local leaders make.
   12. Local leaders take advantage of their position.

E. External interventions
   13. Development organizations do not fulfill their promises towards the people.
   14. The state representatives try to resolve the problems of the whole community.
   15. The local government has solved all the problems it could.

F. Respect for the law
13. When a merchant cheats someone, there is no way of getting justice.
14. State laws are more important than the rules of the local community.
15. When a patron does not respect the rights of a worker, there is no way of getting justice.

Notes

This research has been made possible by the financial support of the Special University Research Fund of the Flemish Community and the Flemish NGO Broederlijk Delen. The authors also relied on the collaboration of researchers from the Institute Nitlapán of the Universidad Centroamericana, Managua, Nicaragua, and of Katrijn Ruts, who participated in the field data gathering.

1. This general definition corresponds to Douglas North’s players and institutions/rules (North, 1990) as well as to the more popular concept of “social capital” as defined in the World Bank Social Capital Initiative (Woolcock & Narayan, 2000). For a detailed discussion of these conceptual issues, see Vaessen & Bastiaensen (1999) and Bastiaensen & Vaessen (2002).

2. For details about the historical experience of the Fondo de Desarrollo Local, see Bastiaensen (2000) and Rocha (in press).

3. The 18 largest microfinance institutions are organized in the Nicaraguan Microfinance Association (ASOMIF). These 18 institutions have increased their portfolios from US$19.7 million in 1997 to US$49.7 million in June 2001, with an increase from 18,700 to 125,200 active clients (Gutierrez, 2002). 41% of their portfolio is directed to the rural sector—a substantially higher proportion than in most other Latin American microfinance sectors. ASOMIF is very active in lobbying for legislation that will allow a further healthy expansion of its sector of sustainable microfinance enterprises.

4. For reasons of privacy, the names of the villages have been changed.

5. This policy of the Sandinista government can be explained by the combination of both a socialist bias in favor of state planning/entrepreneurship and the politico-military necessity to maintain a minimum (food) production level within the war (survival) economy.

6. From the very beginning of the agrarian reform, there was pressure from the cooperative members to allow individual production on the reformed land. Consequently, by the mid-80s there were already many cooperatives with mixed collective and individual production.
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7. For each dimension, three questions (see appendix) were posed and scores per dimension were constructed by summing the scores for three individual questions per dimension. The perception indices were constructed as the normalized mean of the scores per community. The total perception index is equal to the mean of the six perception indices.

8. In 1995 a new credit program was created in both communities, with long-term investment loans principally directed to former agrarian reform beneficiaries. However, the same perceptions of external assistance and credit affected the repayment incentives of the clients, resulting in similar program performance as in the case of the FDL program (see D’Exelle & Bastiaensen, 2002, for further details). This experience confirms once again our hypothesis regarding the relations between local institutional environments and the performance of microfinance programs.
Challenges to Microfinance Commercialization

by Anita Campion

Abstract: This paper was presented to audiences in Vietnam, Indonesia, Singapore and the Philippines through a World Bank multimedia distance education program in October 2001. The presentation addressed some of the core obstacles to microfinance commercialization, defined here as the application of market-based principles to providing financial services to the poor. The paper discusses some of the challenges to microfinance commercialization, such as inappropriate donor subsidies, poor regulation and supervision, and limited management capacity of microfinance institutions. Given the initial target audience of primarily World Bank employees, the paper concludes with a discussion on what donor can do to move microfinance commercialization forward in a positive direction.

Introduction

As Marguerite Robinson describes in *The Microfinance Revolution*, the 1980s demonstrated that “microfinance could provide large-scale outreach profitably,” and in the 1990s, “microfinance began to develop as an industry” (2001, p. 54). In the 2000s, the microfinance industry’s objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty. While much progress has been made in developing a viable, commercial microfinance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand. The obstacles or challenges to building a sound commercial microfinance industry include:
Inappropriate donor subsidies
• Poor regulation and supervision of deposit-taking MFIs
• Few MFIs that mobilize savings
• Limited management capacity in MFIs
• Institutional inefficiencies
• Need for more dissemination and adoption of rural, agricultural microfinance methodologies

This paper addresses some of the challenges to microfinance commercialization and concludes with a discussion of the types of donor support needed to ensure that the industry meets these challenges in the years to come. Chemonics is currently working on a project with the Asian Development Bank to document the commercialization of microfinance in four Asian countries. The findings of that study, which will be available in 2002, will offer additional insight into the specific obstacles to commercialization faced by microfinance institutions in Bangladesh, Indonesia, the Philippines, and Sri Lanka.

Inappropriate Donor Subsidies

One of the greatest obstacles to commercial microfinance is the continued subsidization of the industry by donors. The industry can credit donors with helping to support the initial pilot projects, institutions, and research that together led to the development of sound lending methodologies for microfinance. However, as the microfinance industry matures, it has become less clear how donors can support the continuing advances in the industry without discouraging natural market mechanisms. While donor support for institutional capacity building is still needed, the availability of grants and soft-loans for on-lending keeps microfinance institutions from pursuing more commercial sources of capital, including savings mobilization and commercial debt and equity funding. For example,

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Challenges to Microfinance Commercialization

the Grameen Bank continues to be donor dependent, reporting $16.4 million in direct grants and $126.5 million of implicit subsidies in 1998 (Robinson, 2001, p. 95). This focus on donor support has kept Grameen Bank from implementing credit technologies that would lower operational costs and make savings rates more attractive to clients.

Poor Regulation and Supervision

Many countries around the world have limited capacity to regulate and supervise their traditional financial institutions, and developing countries in particular are often accused of poor regulation and supervision of the formal financial system. Given that microfinance is especially needed in developing countries, many countries are ill equipped to provide the additional oversight needed to regulate and supervise microfinance institutions (MFIs) that mobilize deposits. For regulation and supervision of microfinance institutions to be effective, the regulators must understand the differences between traditional finance and microfinance. Common regulatory adaptations for microfinance institutions are as follows:

- *Lower capital requirements.* Minimum capital requirements should be low enough to attract new entrants into microfinance but high enough to ensure the creation of a sound financial institution.

- *Waiver of usury rates.* Regulators should allow MFIs to charge higher interest rates in order to cover higher transactions costs associated with microfinance lending. China and India are two countries with huge potential microfinance markets that are greatly inhibited by laws regulating usurious interest rates.

- *Risk weighting of assets for unsecured loans.* Regulators should assess the riskiness of MFIs based on overall portfolio quality and repayment history rather than on the value of traditional guarantees.
<table>
<thead>
<tr>
<th>MFI Name</th>
<th>Country</th>
<th>No. of Active Savers (no.)</th>
<th>Voluntary passbook and time deposit savings (US$)</th>
<th>Average Savings Deposit (US$)</th>
<th>Total loan portfolio ($)</th>
<th>Portfolio Funded by Savings (%)</th>
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<tbody>
<tr>
<td>ACEP (1998)</td>
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<td>13,327</td>
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<td>60.66%</td>
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</tbody>
</table>

Source: MicroBanking Bulletin data published with permission of the MicroFinance Network members.
Challenges to Microfinance Commercialization

- **Stricter provisioning.** Provisioning requirements should be based on the average loan maturity of the portfolio. Microfinance portfolios tend to have shorter average maturities, and they therefore require more aggressive provisioning.
- **Higher operating costs allowed.** Since MFIs manage small loans and deposits, they tend to have higher operational costs than do traditional banks. Regulators should not penalize MFIs for higher operating costs if they can demonstrate a reasonable average return on assets (Berenbach and Churchhill, 1997, p. 43).
- **Customized reporting requirements.** Not all the reporting requirements of traditional banks are applicable to MFIs, and microentrepreneurs usually cannot produce the same amount of documentation required of traditional lending.

**Few MFIs Mobilize Savings**

Most microfinance institutions that exist today operate as non-profit microfinance nongovernmental organizations (NGOs). These NGOs are not regulated financial institutions and therefore are usually not permitted to mobilize client savings. Even among commercial microfinance institutions, few have mobilized a significant amount of voluntary client savings. Table 1 summarizes statistics for some of the most advanced microfinance institutions, including the amount to which they fund their loan portfolios with savings. Bank Rakyat Indonesia (BRI) is a good example of a microfinance provider that has grown significantly as a result of its strong commitment to savings mobilization. In fact, BRI has been so successful that its microfinance division has been cross-subsidizing its commercial loan division for years and has helped stabilize the institution through the recent economic crisis in Indonesia. The industry as a whole needs to learn more about microsavings mobilization and can benefit from the lessons learned by BRI, credit unions, and other institutions that have successfully satisfied the demand for microsavings accounts.
Limited Management Capacity in MFIs.

Since many of the MFIs began as NGOs with a social mission to reduce poverty through the provision of loans, few MFIs have the management capacity to successfully manage a commercial financial intermediary. One of the greatest needs to develop a commercial microfinance industry is the building of management capacity in the following areas:

- **Risk management.** As MFIs take on the additional risk involved with savings mobilization, including increased liquidity risk, fiduciary risk, interest rate risk, and exchange rate risks, more risk management expertise is needed at the board and senior management levels.

- **Management information and internal control.** As MFIs grow, they need to ensure that their management and internal control systems are responsive to the MFI's changing risk profiles and management's changing needs for information to monitor and control these risks.

- **Marketing and customer responsiveness.** To satisfy demand and retain good clients, MFIs need to better understand and respond to their clients' diverse financial needs and customer service preferences.

- **Human resource development.** As the industry becomes more competitive, MFIs often lose their best employees to the competition. MFIs need help in developing sound human resource policies and incentive systems to ensure that they retain the best employees in a cost-effective manner.

**Institutional Inefficiencies**

Over their history, many MFIs have found ways to increase productivity and efficiency and to lower costs. These efficiency improvements have helped several MFIs to achieve operational and financial self-sufficiency. Asia boasts some of the most efficient microfinance institutions, with both the Association for Social Advancement (ASA) (Bangladesh) and BRI (Indonesia) reporting administrative expense ratios of only 10.5% and 14.1% in 1998 respectively (Campion, 2000, p. 3). The average administrative expense ratio of the 56 MFIs
Challenges to Microfinance Commercialization

contained in the MicroBanking Bulletin in 1998 was 36.6%. However, more MFIs will need to lower operating costs further before the industry will be able to attract a significant amount of commercial capital. To improve efficiency and customer satisfaction, many MFIs are exploring the use of new technologies, such as Palm Pilots and smart cards to lower transactions costs and increase outreach.

Need for More Rural, Agricultural Microfinance Methodologies

Microfinance has been particularly successful in densely populated urban areas and in countries with large informal sectors. Past donor-supported agricultural lending programs were largely unsuccessful. However, new rural finance models are being explored, offering potential for addressing poverty in rural areas. Chemonics’s Mindanao Assistance to Banks (MABS) project has helped set up microfinance units in private banks in the Philippines. From working on this project and others, Chemonics has learned that successful rural microfinance requires that financial officers be knowledgeable of local rural and agricultural markets, standard crop cycles, and seasonal fluctuations in revenues and expenditures. By building the capacity of rural loan officers, Chemonics’s project in the Philippines has facilitated access to financial services to 19,000 borrowers and 53,000 savers in previously underserved rural areas. After just three years, 19 of the 20 rural bank units with which the project has worked are profitable. By demonstrating that microenterprise lending is profitable and that micro-savings can be a stable and low-cost source of funds, other banks are now interested in entering the rural finance market.

Conclusion

To summarize, the commercialization of the microfinance industry faces several obstacles that need to be addressed before world demand can be more adequately served. In general, donors should avoid using direct subsidies that will result in market distortions. Donors can support the continued development of the microfinance industry by paying for some
technical assistance and training, but it should limit direct subsidies to MFIs for on-lending. In addition, donors can help to improve the environments in which MFIs operate by building capacity in the regulatory and supervisory bodies, supporting the creation of credit bureaus, and creating other information support systems and networks. As donors move away from direct subsidies and toward capacity-building support, the industry will attract more commercial capital and be better equipped to satisfy unmet global demand. In satisfying this unmet demand for financial services, MFIs will support low-income people in their efforts to rise above poverty.

Notes

1. While some would rightfully argue that credit unions are commercial microfinance providers, few credit unions are dedicated primarily to microfinance and therefore are not categorized here as MFIs.

2. Administrative expense ratio is measured here as administrative expenses over total loan portfolio.

Works Cited


Challenges to Microfinance Commercialization


Evaluation and Microenterprise Programs in the United States

by Mark Schreiner

Abstract: Microenterprise programs attempt to help poor people start or strengthen small businesses. Funding and political support have grown rapidly. Is microenterprise a good use of scarce development funds? Unfortunately, most evaluations have been case studies in what not to do. Because benefits and costs cannot be measured completely nor with perfect certainty, rigorous evaluations should support their necessarily subjective judgments with logic and explicit assumptions. The usefulness of an evaluation lies not in its (apparent) incontrovertibility but rather in its clarity of assumptions and in its openness to meaningful review and critique.

Introduction

This paper reviews evaluations of microenterprise programs that make loans and provide training to help the poor, the unemployed, and the recipients of public assistance start or strengthen small businesses. Success stories of microenterprise abroad have inspired growth in the number of U.S. programs from almost none in the 1980s to more than 340 in 1999 (Langer, Orwick, & Kays, 1999). Federal support has also grown steadily (Else, 2000). The growth of microenterprise may, however, draw resources away from other, possibly better, interventions (Howells, 2000).

Is microenterprise a good use of scarce development funds? Scholars disagree. Raheim (1996a, p. 69) says that evaluations
show that programs "create opportunities for clients to engage in productive self-employment which will restore self-respect, facilitate self-reliance, and above all transform a condition of dependency to one of self-sufficiency." Bates (1997) says that such claims are not yet backed by careful evidence.

Because microenterprise is new in the United States, most evaluations focus on process—they ask, "What happened?" Process evaluation is important (Woller, Wheeler, & Checketts, 1999), but as the budget for microenterprise grows, evaluations should also measure impact—they should ask, "What benefits were created and at what cost?"

Of course, impact evaluation is expensive and difficult. Measures of benefits and costs—especially in the absence of the intervention—are always incomplete and imprecise. All evaluations, whether qualitative or quantitative, necessarily rest partly on subjective judgements. A good evaluation is not one whose conclusions seem incontrovertible but rather one that is open to review because the logic that derives conclusions from measurements and assumptions is clear. The goal of rigorous evaluation is to put everyone “on the same page” so that discussion can focus on differences in methods of measurement, logic, or assumptions.

Evaluation so far has not shown whether microenterprise programs are worthwhile. This paper discusses how to improve evaluation through more rigorous estimation of benefits and costs both with and without the program. The paper highlights examples that avoid common pitfalls and emphasizes that funders create the incentives for careful or careless evaluation. As a simple first step toward improvement, the paper proposes comparing costs with outputs. The insights are applicable not just for microenterprise but also for evaluation in general.

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Volume 4 Number 2
Rigor

What is rigor? This section argues that evaluations are inevitably subjective but that rigor constrains excesses. Rigor implies transparency in the evidence, logic, and assumptions that support conclusions. Rigorous evaluations are susceptible to critique and thus more likely to be improved.

All Evaluations Are Subjective

Evaluation compares net benefits with an intervention versus net benefits without the intervention. Some types of benefits and costs (such as changes in income) can be quantified. Other types (such as changes in feelings of self-worth) are necessarily qualitative, but all types should be considered in the final judgement (Plotnick & Deppman, 1999). Even if all effects could be converted to common units (such as dollars), the conversion would inevitably involve subjective judgements such as "a year of life is worth $x" or "people are willing to pay $y to feel this change in happiness."

Quantification is still useful, not for its own sake but rather because it helps to make assumptions and judgements explicit. For example, financial benefit-cost analysis must be explicit about the financial costs and benefits included and must either assume away nonfinancial effects or make an explicit qualitative judgement about them.

Rigor Constrains Excess Subjectivity

Rigor aims to improve interpersonal reliability. Some subjectivity is inevitable, but excesses occur when judgements rest on unexamined experience, fuzzy logic, or implicit assumptions. Subjectivity is nontransparency; opaque or implicit factors lack interpersonal reliability, and this might let mistakes sneak through (McCloskey, 1998). The heart of the social-scientific method is not experiments but explicitness.

Objectiveness or subjectiveness inheres not in an effect but rather in its measurement. Qualitative benefits and costs are unmeasured, unmeasurable, or measured in units with low
interpersonal reliability; quantitative measures have high interpersonal reliability. Analyses are more rigorous as they depend less on the experience and judgement of a specific analyst.

Rigorous evaluations measure what they can and then point out the subjectivity that remains. Often, simply making explicit the factors that influence a judgement provokes ideas for improvement or spotlights gaps in logic. Rigor whittles away unneeded subjectivity and highlights unresolved subjectivity.

Evaluations are inevitably subjective to some degree, and this is not bad. Good subjective judgements, however, are more than mere opinion; they are derived logically from explicit assumptions. Rigor makes the factors behind a judgement as transparent to others as to the analysts. This forces analysts to check their work, and it provides a basis for the type of reasoned discussion that could lead to improvement.

Cost Measurement

Evaluations of microenterprise programs often understate costs in that they ignore opportunity costs, costs borne by participants, and costs of displaced nonparticipants. The issue is less that costs are ignored and more that they are implicitly ignored. Casual readers might mistakenly infer that all costs were measured.

After introducing the major evaluations of U.S. programs, this section discusses three often-overlooked types of costs. The next section discusses the measurement of benefits. Even without knowledge of benefits, knowledge of costs is useful.

Major evaluations

There are four major evaluations of U.S. microenterprise programs. The first—the Self-Employment Learning Project (SELP)—tracked seven of the oldest and best-known microenterprise programs (Clark, Kays, Zandniapour, Soto, & Doyle, 1999; Edgcomb, Klein, & Clark, 1996). Second, Himes and Servon (1998) analyzed six programs affiliated with Accion
International, the U.S. network with the most clients. Third, the Self-Employment Investment Demonstration (SEID) followed seven programs targeted to recipients of public assistance (Raheim and Alter, 1998; Raheim, 1997, 1996a, and 1996b; Friedman, Grossman, & Sahay, 1995). Fourth, the Unemployment Insurance Self-Employment Demonstration (UISED) tested the effect of access to microenterprise services for the newly unemployed (Benus, Johnson, Wood, Grover, & Shen, 1995).

**Opportunity Costs**

Resources employed in microenterprise development could have been employed elsewhere and so have an opportunity cost. Most microenterprise evaluations use incomplete measures of opportunity costs or no measures at all.

Suppose an evaluation covers $T$ years and that the net benefit of a dollar in the best alternative project (the opportunity cost) is $r$. The standard assumption is that $r$ is 10% per year in real terms (U.S. Office of Management and Budget, 1972).

Let $E_0$ be the resources (equity) in the program at the start of the time frame, let $P_t$ be the profit (or loss) in year $t$ if the program had paid market prices for its resources, let $F_t$ be the net funds transferred to the program in year $t$, and let $d=1/(1+r)$. Present cost as of the start of the time frame is then:

$$
\text{Present Cost} = (1-d) \cdot E_0 + \sum_{t=1}^{T} ((d^{t-1}) \cdot F_t - d^t \cdot P_t)
$$

The first term, $(1-d) \cdot E_0$, is the difference between the present worth of start equity $E_0$ at the start of the time frame and at the end. The second term, $(d^{t-1}) \cdot F_t$, is the difference between the present worth of net funds $F_t$ in year $t$ and in year 0. Net funds $F_t$ include grants in-cash, the market value of grants in-kind, and expenses avoided due to soft liabilities with below-market interest rates. The third term, $d^t \cdot P_t$, is the present worth of profit from year $t$ in year 0. The measure of profit $P_t$ excludes grants recorded as revenue, but it includes expenses
that would be incurred in the absence of grants in-kind and soft liabilities.

No major U.S. evaluation measures the present value of costs. UISED and SELP count costs as funds spent, but they do not discount, adjust for soft liabilities, or measure grants in-kind. The cost study for SEID is not yet public (S. Raheim, personal communication, 1998). The Accion evaluation did not measure costs.

**Costs for participants**

Microenterprise participants experience both benefits and costs. No major evaluation measures price costs or nonprice transaction costs borne by participants.

**Price Costs**

Prices paid by participants include interest and fees for loans and for training. Evaluations of programs that make loans should measure price costs as the real monthly effective interest rate—that is, as the inflation-adjusted internal rate of return (IRR)—on all cash flows associated with a loan. The IRR accounts for the effects of nonprice terms of the loan contract such as the number, frequency, and timing of installments; deduction of fees from disbursements; term to maturity; and compensating balances. As a picture of the true cost of debt for borrowers, the IRR is preferred to the annual percentage rate that lenders must report by law.

**Nonprice Transaction Costs**

Both borrowers and trainees incur transaction costs. More difficult to measure than price costs, transaction costs are often overlooked, but they may swamp price costs (Adams, 1995). These costs can be seen in terms of money, miles, and minutes: the out-of-pocket expenses incurred to participate but paid to someone other than the program, the cost of transport, and the opportunity cost of time.
Transaction costs do not vary much with loan size, so they impinge most on the poorest because they get the smallest loans. For example, suppose a loan of $1,000 has a price of zero and is repaid in one installment after one year. The borrower, however, may be required to take classes, attend monthly meetings, complete a business plan, and join a joint liability group. These requirements can take up to 90 hours (Raheim, 1995; Clark and Huston, 1993; Else and Raheim, 1992). If borrowers do not want or need extra help, the opportunity cost of time can make even a "free" loan quite expensive. For example, if time is worth $6 an hour, then a $1,000 "free" loan that consumes 90 hours is equivalent to $1,000 of credit card debt with an annual price of $6 \times 90 / $1,000 = 54\%$. Transaction costs matter most for small loans, which is why credit cards, payday loans, pawn shops, and the best microenterprise programs abroad can charge high interest rates but must provide streamlined service (Caskey, 1994).

**Displacement Costs for Nonparticipants**

A microenterprise program may help one small business at the expense of another (Garfinkle, Manski, & Michalopoulos, 1992). Because the poor often lack skills and wealth, they cluster in sectors with low barriers to entry (Bates, 1997). There, competition is high, profits are low, and one firm's gain may be another's loss. Displacement is very difficult to measure, but it may be as high as half of the net benefits of participants (Bendick and Egan, 1987). No major U.S. evaluation discusses displacement costs.

**Benefit Measurement**

The previous section argued that evaluations of microenterprise programs understate costs. This section argues that they overstate benefits.

Participants do get positive net benefits from microenterprise programs; if not, they would drop out. For process evaluations, mere participation may imply success. From a social
perspective, however, the key question is not whether there are benefits, nor whether net benefits are positive, but rather whether net benefits are so positive that microenterprise is better than other ways to reach the same goals. Because the poor are plenty but the funds are few, evaluations should measure not just the sign of benefits but also the size of both benefits and costs.

Measurement of benefits faces two challenges. First, as discussed in the next section, participants are observed only with participation, not without. Second, as discussed in this section, benefits are not observed, so proxies based on output or outcomes are used. Issues with these proxies include the proper units, aggregation, absolute versus relative measures, and a one-sided focus on positive outcomes.

Units

Jobs

The output of microenterprise programs is often measured in units of “jobs created.” Not all jobs, however, are created equal. The best convention is to measure full-time equivalents. No major evaluation does this. For example, SEID reports the total number of self-employed participants, whether high paid, low paid, full-time, or part-time. This overstates benefits because most self-employment is low paid and part-time (Spalter-Roth, Hartmann, and Shaw, 1993).

Some evaluations count as “strengthened” or “saved” all jobs in businesses owned by participants (Clark & Huston, 1993). Without knowing what would have happened without the program, these numbers do not mean much.

Stocks and Flows

Some work fails to distinguish between stocks and flows. For example, two censuses of U.S. programs (Langer, Orwick, & Kays, 1999; and Severens and Kays, 1997) report average loan sizes and numbers of borrowers but do not say whether these
are loans disbursed or loans outstanding. Failure to distinguish stocks and flows allows programs to report the largest number. This also matters for training. For example, the average program in 1999 “served” 202 people, most of whom were trainees (Langer, Orwick, & Kays, 1999). The flow of trainees in a year likely exceeds the stock at any point. (Furthermore, the number of trainees “served” likely exceeds the number graduated.) The right unit depends on the question asked, but units should always be reported.

**Business Starts**

Some evaluations report the number of business starts as if firms sprang to life all at once. This is too simple for three reasons: First, participants may join programs with a business already open. Second, dropouts may still start businesses. Third, most new ventures (53%) fail within four years (Berger and Udell, 1998). As explained by Raheim, Alter, and Yarbrough (1996, p. 93), “starting a business is a process rather than an event,” so evaluations should track progress through a series of landmarks such as a business plan, legal establishment, the start of work, and survival through time.

**Income**

Income measures have three common weaknesses. The first is to report not changes but levels. Levels overstate benefits unless income is zero without the program.

The second common weakness is to report income instead of returns. Returns account for time worked and capital invested. Bates (1997) and Drury, Walsh, and Strong. (1994) do report returns. Bates computes profit per hour of owner labor and deducts a 10% return to capital. Drury et al. report not just average profits of $1,200 per month but also average returns on owner labor of $6.70 per hour. This figure is useful because it can be compared with the $12.41 per hour earned before unemployment and with the $10.55 per hour earned by participants in parallel job-training programs.
The third common weakness is failure to define income. Himes and Servon (1998) state that self-employment income might be seen as revenue, revenue less expenses, owner's draw, or change in retained earnings. In fact, the correct measure is business profit before taxes and before owner's draw. Some evaluations report business revenue, perhaps because it is higher than income. For example, Raheim (1996a) reports an average "income" in SEID of $21,000, even though, according to Servon and Bates (1998), revenue net of expenses was about $3,000.

**Aggregates and Averages**

Some evaluations report cumulative flows rather than annual flows. For example, Langer et al. (1999) report that the 341 programs in their census served 250,000 people and made loans for $160 million (average age was 7.5 years).

Cumulative flows mask current performance by mixing it with past performance. A figure of 250,000 cumulative participants may sound better—but conveys less—than a figure of 100 participants per program per year.

Aggregation over participants is also contraindicated. For example, Raheim et al. (1998) report that total sales were $3.5 million for participants in the programs in Drury et al. (1994). More useful, if perhaps less impressive, is that income per participant per year was about $12,000.

**Nonpositive Measurements**

Some evaluations accent the positive and downplay or omit everything else. In principle, evaluations are not proofs but tests, and evaluators are "agnostic or open-minded about a project.... [They] should neither justify nor act as hatchets" (Nares, 1995, p. 33). In practice, evaluations "routinely cite impressive-sounding, yet very selective statistics on program success" (Bates, 1996, p. 28).
Evaluation and Microenterprise Programs

Half statistics
A common practice is the "half statistic." For example, Severens and Kays (1997) note that 30% of participants were low income; they do not mention that 70% were not. A good example that avoids this is Raheim and Alter (1998), who report the share of participants whose self-esteem grew, fell, or did not change.

Dropouts
Improvement requires feedback on weaknesses as well as on strengths, but data on dropouts are conspicuous in their absence. After all, dropouts are the simplest way to evaluate value to participants: they will leave unless they expect positive net benefits. Measurement of dropouts is standard for microenterprise abroad (Rosenberg, 2001), but Himes and Servon (1998) is the only U.S. evaluation to discuss dropouts.

Loan repayment
Evaluations of programs that make loans should analyze repayment. A program that does not recoup its loans cannot help many poor people and cannot be sure that it helps the most deserving. Arrears plague many U.S. programs (Bhatte, Tang, & Painter, 2001).

The best measure of arrears is aged portfolio at-risk. This is the entire balance of all loans with any installments overdue, divided by the whole portfolio, and grouped by the age of the oldest overdue installment. Few evaluations report aged portfolio at-risk. The measures commonly reported understate the risk of loan losses. For example, Servon (1996) reports the number of loans overdue. This serves some purposes, but it misses the greater risk of larger loans. Payments overdue understate risk because it ignores that one missed payment signals greater risk for the entire loan balance. Edgcomb et al.
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(1996) report recuperation, the ratio of cash received to cash due. Recuperation usefully measures the rate of loan losses in the past, but it may not reflect current risk. A quick test for the quality of a lending program is whether it routinely measures repayment, especially aged portfolio at-risk (Moll, 1997).

What Would Have Happened
Impact is what happened with a microenterprise program that would not have happened without it. The “with” case did happen, so behavior of treatments (eligibles or participants) can—in principle—be directly measured. The “without” case did not happen, so behavior cannot be directly measured. The central challenge of evaluation is the estimation of the counterfactual, behavior in the “without” case (Moffitt, 1991).

UISED estimated the counterfactual carefully and took impact as with-versus-without; other evaluations took impact as before-versus-after. Before-versus-after allows direct measurement of a counterfactual (before the program), but it falsely ascribes all changes to the microenterprise program. With-versus-without is preferred.

Before-versus-After
Before-versus-after counterfactuals have three problems: they assume that the program caused all changes, they ignore the self-selection of treatments, and they ignore the self-selection of survivors.

Time Trends
Microenterprise programs surely affect some outcomes, but they just as surely are not the sole cause of all outcomes. However, the typical evaluation (e.g., SEID and SELP) ascribes all income and all business start-ups and expansions to the program. The (implicit) counterfactual of no microenterprise without the program is unlikely.
With before-versus-after data, the assumed counterfactual—as always—should be explicit. Also, the analyst should ask participants about impact. Servon (1996, p. 47) found that “nearly all the women interviewed had already started or claimed that they would have started their businesses whether or not [the program] existed.”

**Self-Selection of Participants**

People who expect high net benefits are more likely to join a microenterprise program than people who expect low or negative net benefits. Thus, the average net benefit for participants probably exceeds the average net benefit for eligibles, had they participated. This is self-selection bias.

One way to mitigate self-selection bias is to control for differences in observed traits (for example, sex, education, or work experience) between eligibles who choose to join and those who do not. Sanders (2000) controls for a few observed traits with data from SELP and from the Panel Study of Income Dynamics. He finds much smaller impacts than Clark et al. (1999), who did not control for any observed traits.

Controlling for observed traits is a useful start, but unfortunately, self-selection also depends strongly on unobserved traits. Because entrepreneurship requires independent work with high risks, people with unobserved oomph and hustle have the best chance to succeed and thus have higher expected net benefits. Even with observed traits constant, differences before-versus-after a microenterprise program are due partly to participation and partly to existing spunk and grit. Ignoring the effects of unobserved traits overstates the effects of the program. Again, this is self-selection bias.

UISED is the only major evaluation to account for self-selection on both observed and unobserved traits. Except for Raheim and Alter (1998), no major evaluation controls even for observed traits.
Self-Selection of Survivors

People with high expected net benefits are more likely to complete a program, start a business, and keep it open. Expected benefits depend not only on the program but also on observed and unobserved traits. Thus, before-and-after analyses that credit programs for all changes in participants who have not dropped out or closed their businesses overstate impact. This is survivor bias, a type of self-selection bias.

Survivor bias may explain part of the positive link between profits and repeat loans found by Himes and Servon (1998) for Accion and by Clark and Huston (1993) for SELP. Servon and Bates (1998) suggest that survivor bias may also explain why profits in SEID (Raheim, 1996a) were three times higher than for self-employed women in a broader sample studied by Spalter-Roth, Soto, and Zandniapour (1994).

Control Groups

In before-versus-after studies, outcomes for treatments before treatment provide the counterfactual. In with-versus-without studies, outcomes for nonparticipants or noneligibles—control groups—provide the counterfactual.

Principles

The ideal control group has the same joint distribution as the treatment group for all traits—observed and unobserved—that affect the outcome. The closer the joint distributions, the better the control group. If controls match treatments in all ways except for treatment, then all differences in outcomes can be attributed to treatment.

Experiments. A good control group is hard to find. To avoid self-selection bias, controls must lack choice about treatment. (Panel data or econometric models may also allow more complex controls for self-selection, Reichart & Mark, 1998; Moffitt, 1991.) The gold standard for exogeneity in treatment status is random assignment, either through design or through nature (Manski, 1995; Meyer, 1995).
In a classic experiment, the evaluator excludes some eligibles (or qualified applicants) at random. This purges self-selection bias because treatment is uncorrelated with individual traits. UISED is the only classic experiment in microenterprise.

In a “natural” experiment, constraints outside the evaluation eliminate choice for some potential treatments. For example, a metro area might straddle state borders, with only one state providing its residents with access to microenterprise programs. Natural experiments typically require more assumptions than classic experiments—for example, that people do not switch states to take advantage of programs.

Even with some types of experiments, impact evaluation is difficult (Heckman and Smith, 1995). Severe threats to validity plague even medical trials, where evaluations can affect thousands of lives and perhaps billions of dollars (Mason and Drummond, 1995). The most common weakness is the simple failure to make assumptions explicit.

Comparison Groups. Comparison groups match treatments with nontreatments on a small set of observed traits such as sex, location, and receipt of public assistance. Although both groups have the same joint distribution for these traits, they may not have the same joint distribution for other traits. Thus, comparison groups are an inexpensive (but imperfect) substitute for experimental control groups. The only use of comparison groups in microenterprise is Raheim and Alter (1998) and Sanders (2000). Comparison groups are useful as long as the assumptions required to derive estimates of impact are explicit. Otherwise, users may remain unaware that impact is likely overstated.

Practices. Himes and Servon (1998, p. 8) write that “the field desperately needs some research that uses a control group.” Four factors help to explain why no major evaluation except UISED has used control groups.

First, control group evaluations are lengthy and expensive. Unfortunately, donors, governments, and programs often seek quick evaluations, perhaps to support requests for the next
tranche of funds. The high cost of rigorous evaluation means that even the biggest funders can afford only a few evaluations.

Second, some program staff believe that experiments are ethically wrong. After all, programs were started precisely to combat the arbitrary injustice that random assignment seems to perpetrate. This belief fails to consider that resources in microenterprise might help the poor more in some other development intervention.

Third, some impacts elude quantification even with control groups. For example, increased self-esteem may be the most important effect of participation (Raheim and Alter, 1998; Spalter-Roth et al., 1994). Many effects are indeed too complex, subtle, diffuse, or long-term to be quantified at low cost, but disciplined arguments about qualitative judgements are still possible if based on ruthless logic and explicit assumptions. Bates (1997 and 1996) critiques SEID not because the conclusions are based on qualitative criteria but rather because the criteria are left unstated.

Fourth and most important, most evaluators have been advocates. Although most were probably unaware of the weaknesses of their methods, few were disappointed when impacts turned out to be large and positive.

The dirty secret in microenterprise (and elsewhere, Adams, 1988) is that few evaluations are really tests. Except perhaps for UISED, evaluations were funded and conducted by people who already believed that microenterprise was worthwhile. Thus, the projects are called "demonstrations," not "tests." They sought not to check whether microenterprise works but rather to convince funders and policymakers that it works. Rigor is secondary to showing large impacts.

These are disturbing claims. Often, evaluators were simply unaware of the weaknesses in their analyses. Sometimes, however, they were aware and chose nonetheless to disseminate figures biased in favor of microenterprise. For example, descriptions of the benefits from SEID are widely published, but the cost study—though completed—is not yet available.
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Benus et al. (1995) were extremely rigorous in that they estimated two sets of impacts for UISED, one including an outlier with income of $500,000 a year and another excluding it. Subsequent discussion, however, tends to focus on the (more positive) results that include the outlier. Likewise, UISED had two sites, one with positive impacts and one with almost no impact. The policy derived from the report (Vroman, 1997) focuses on the positive impacts. Finally, the SELP data has some very large figures for changes in income and assets, likely due to misplaced decimal points. Sanders (2000) says medians would be more appropriate measures (or elimination or correction of outliers), but Clark et al. (1999) use means.

In short, evaluators did not always fix known biases. Some argue that there is a prisoner’s dilemma in evaluation; greater rigor would destroy microenterprise’s chances with policymakers against competing, nonrigorous proposals. Thus, challenges to the evaluation of microenterprise probably mirror challenges to evaluation in general. Policymakers, however, are not stupid, and they may grow to regard evaluation as little more than social-science fiction.

Discussion and Recommendations

Is microenterprise a good way to help the poor? Three of the four major evaluations say that it is. For SEID, Friedman et al. (1995, p. 16) say that “proliferation of self-employment programs in the United States since (and because of) SEID bodes well for the broad opening of a realistic self-employment option for welfare recipients.” For SELP, Clark et al. (1999, p. 68) say that “microenterprise can offer an effective entry point into the mainstream economy for the poor.” For UISED, Benus et al. (1995, p. xi) say that “self-employment assistance is a cost-effective approach to promote the rapid re-employment of unemployed workers and should be permanently incorporated into the U.S. employment security and development system.”
This paper argues for more caution. It concurs with Servon and Bates (1998, p. 28) in that "the microenterprise strategy needs better evaluation." Undoubtedly, impact has been positive, and some participants have turned their lives around. The question for public policy, however, is not whether some people benefit but whether the poor as a whole are better off with microenterprise than with something else. The following recommendations will guide improvement: beware of backlash, reward rigor, and compare outputs with costs.

_Beware of Backlash_

If microenterprise is worthwhile, then the case should stand up to rigorous analysis. If it is too soon to judge, then evaluations should note this and then argue from explicit assumptions how quickly the required improvement might occur.

In the long term, people will realize that microenterprise is not a panacea, and the backlash may sting. Bates (1996, p. 28) says that "advocates put their cause at risk when they substitute inflated claims and selective statistics for serious analysis." Microenterprise has benefits and costs, and experience abroad suggests that failure to account for both sides can harm the poor in the long term (Adams, Graham, & Von Pischke, 1984).

Weak analysis can hurt in three ways. First, advocacy distracts effort from the use of feedback to improve performance. Failure is often a better teacher than success. Second, better measurement might improve workaday management. If managers do not know how well they perform, then they are unlikely to try to improve. Third, overstated claims may divert funds from projects that could help the poor more. The goal is not more microenterprise but rather improved well-being for the poor.

Benus et al. (1995) is an ideal example of rigor. The thoroughness of the report was such that a detailed critique (with different conclusions) was possible (Schreiner, 1999). Another excellent example is the financial benefit-cost analysis of Individual Development Accounts (matched savings accounts for the poor that may be used to capitalize microenterprise) by
Clones, Friedman, Grossman, and Wilson. (1995). This analysis is uncommonly rigorous not because of its accurate measurement (all the numbers are pro forma) but because it carefully enumerates different sources of benefits and costs for different groups and then discusses which benefits and costs might be measured, which cannot be measured, and what assumptions are used to arrive at estimates.

**Reward Rigor**

Government officials and program officers for private funders are rewarded (with promotions, with invitations to speak at conferences or to write prefaces, with feelings of having done good) more for new, successful ideas than for failed experiments. In turn, evaluators suppose that their own rewards (in future contracts) are greatest if a project is deemed successful. Until the rewards for the people who fund and conduct evaluations depend more on the rigor of the process than on the judgement itself, a sanguine bias is inevitable. This does not impugn the motives or morals of funders or evaluators; it merely recognizes explicitly that who pays the piper calls the tune.

The incentive structure should reward learning not victory. Learning on such a broad scale as a microenterprise movement, however, is extremely difficult to measure. A focus on changes between interim evaluations might provide some incentives in early evaluations to highlight weaknesses that could be resolved before later evaluations.

Funders might also explicitly forbid emotional appeals (for example, photographs of entrepreneurs in reports). Qualitative investigation can convey ideas that nothing else can, but evidence should trump emotion. What matters are not the faces of specific cases but rather the faceless millions who will get the benefits (or bear the costs) if funds are correctly or incorrectly allocated to microenterprise.

Evaluators might receive fixed contracts for x jobs and then no more. Like lame-duck presidents, they might be more willing to say whether the emperor has no clothes.
Finally, funders could link rewards for program officers to blind reviews of evaluations that seek to identify unacknowledged threats to validity or implicit assumptions. This would reward evaluators who make caveats explicit.

**Compare Outputs with Costs**

Perhaps the simplest way to inform judgements of the performance of microenterprise programs is to compare outputs with costs. Like any shopper, funders should know the price tag.

It is less expensive to compare outputs with costs than to compare benefits with costs. Of course, it is also less informative; the analyst must still judge whether the unmeasured benefits associated with outputs could reasonably exceed costs. Still, “cost calculations can provide a useful ‘reality check.’”

Whatever the true size of external benefits, the [funder] must judge that at a minimum the external benefit exceeds this cost for the intervention to be worth undertaking (Devarajan, Squire, & Suthiwart-Narueput, 1997, p. 40).

Comparing outputs with costs forces analysts to make their judgements explicit. A good example is Edgcomb et al. (1996); they argue that their estimated cost of $6,000 per participant is “close” to that of federal job programs ($3,500 per participant) because microenterprise participants are poorer.

Likewise, Edgcomb et al. (1996) estimate that a dollar-year of debt produced in SELP costs $1.47. If social gains are to exceed social costs, then borrowers must get at least $1.47 of surplus per dollar-year of debt.

Schreiner and Morduch (2001) use data from Severens and Kays (1997) and from Langer et al. (1999) to compute an average cost per participant for U.S. programs of about $2,000 in 1996 and $1,300 in 1999. Raheim (1997) also mentions a cost per participant of about $2,000 for SEID. Of course, cost estimates alone do not reveal whether microenterprise is worthwhile, but evaluators might start to ask whether benefits per participant are likely to exceed $2,000.

Servon and Doshna (2001) compare costs per job created across several interventions. (It is not clear whether “jobs” are
full-time equivalents nor whether they are truly impacts of the interventions.) In three microenterprise programs, costs per job ranged from $4,000 to $6,000. In industrial recruitment, costs per job were between $2,000 and $10,000 in one study and between $11,000 to $50,000 in another study. Costs per job were $1,500 to $2,000 in business incubators, $5,000 in a public works program, and $3,000 to $5,000 in revolving loan funds. Servon and Doshna (p. 191) conclude that "on this measure, microenterprise development is well within the scope of other economic-development strategies."

Notes

This work was supported by a grant from the Division of Asset Building and Community Development of the Ford Foundation. Useful comments were received from Dale Adams, Cynthia Sanders, and Michael Sherraden.

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by Caroline E. W. Glackin
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Abstract: This paper provides a framework for the integration of two asset-building instruments, Individual Development Accounts (IDAs) and loans for microenterprise. Initially, it provides an overview of the emergence of the asset-based approach to poverty alleviation in the U.S. context and the evolution of IDAs and microenterprise development (MED). Then, it evaluates the potential role of IDAs in reducing risk using conventional lending criteria. The paper summarizes the findings of initial research on integrated programs and highlights four case studies. Finally, the paper provides some preliminary observations regarding potential benefits and challenges of the integrated approach and proposes an agenda for future research that will test these hypotheses.

American policymakers have traditionally focused on methods of poverty alleviation that maintain or replace the incomes of poor individuals. Poverty is generally defined by relative levels of income. Although public policy in the U.S. has subsidized asset accumulation for the nonpoor for some time, it is only
within the last decade that policymakers have begun to support the accumulation of assets as a viable approach to alleviating poverty. U.S. policy, through the deduction of mortgage interest expenses and the support of 401(k) retirement plans, has subsidized both savings and debt instruments for the accumulation of assets by members of the middle and upper classes. This paper will explore the integration of two important vehicles for asset development and accumulation among the poor: Individual Development Accounts (IDAs), which are matched savings instruments for low-income individuals; and credit for microenterprise, which are loans to support low-income entrepreneurs.

Individual Development Accounts were first proposed by Michael Sherraden (1991) in his pioneering work, *Assets and the Poor*. All IDA programs include financial literacy and asset-specific training. IDAs subsidize savings accumulation for increased homeownership, post-secondary education, and business ownership for low- to moderate-income (LMI) households. Similar to 401(k) retirement accounts, they reward the monthly savings of LMI families through the use of matching funds from a variety of public and private sources.

Microenterprise development (MED) programs have been operating in the U.S. primarily since the mid-1980s. These programs have traditionally provided LMI entrepreneurs with some combination of training, technical assistance, and small loans.

**The Rationale for Integration**

IDAs and microenterprise-based strategies share common goals and methodologies. They support the accumulation of human and financial assets by the poor. IDA programs promote responsible savings behavior and MED programs promote responsible

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credit management, the two complementary sides of the asset-building coin. Establishing the ability and predilection to save can increase both credit-readiness and credit-worthiness. Microenterprise is one of three primary permitted uses of IDAs under current public and private IDA demonstration programs. Currently, there are microenterprise development programs that offer IDAs and IDA programs that provide MED services. Asset-specific training for microenterprise savers often resembles MED training for microenterprise borrowers in both content and design. Despite many synergies, relatively little has been done to link the two strategies explicitly. Even less has been done to develop integrated IDA-MED programs that facilitate seamless transition of participants from one to the other, share training and program staff, seek out joint funding and advocacy opportunities, and promote IDA savings behavior and capital as necessary credit enhancements.

Organizations that operate both IDA and MED programs as independent, stand-alone entities may not only be missing the opportunity to maximize synergies, but they are likely to be duplicating effort, incurring unnecessary program costs and subjecting clients to unnecessary requirements and time commitments. Areas of duplication may include enrollment or intake, eligibility assessments, training, and counseling or one-one-one technical assistance. By designing and implementing integrated IDA-MED programs, managers may minimize costs, increase client retention, and reduce credit risk.

This paper reviews current practice in integrating IDA and microenterprise development strategies, proposes a conceptual framework for weighting IDA participation in credit analysis, and recommends areas for further research.

Increasing Deployment of Loan Capital
Although microentrepreneurs in the United States have expressed a desire to access credit, the levels of demand for and the deployment of microenterprise loan capital have been
much lower than anticipated. Low deployment has serious consequences for the sustainability of microenterprise finance, because, in the long run, programs must depend on interest and fee income from loan portfolios to cover operating costs. According to the Aspen Institute’s Microenterprise Fund for Innovation, Effectiveness, Learning, and Innovation (FIELD), the following are the primary reasons for low rates of deployment (Clark & Kays, 1999):

- Client aversion to debt
- Poor or no credit history
- Access to other sources of credit
- Lack of equity capital

In integrating IDA and MED products and services, programs may ensure that clients have access to financial literacy education, credit repair opportunities, and IDA equity capital, all of which may be valued as credit enhancements during consideration for microenterprise loans. In this way, integration has the potential to address several barriers to low demand and deployment, including debt aversion, credit history, and equity gaps.

Promoting Healthy Capital Structures and Mitigating Lender Risk

Historically, microenterprise institutions, both in the U.S. and abroad, have focused on providing loans to capitalize microenterprises. Low-income microentrepreneurs rarely have access to the equity capital that mainstream financial institutions require to reduce the risk of a small business loan. To compensate for this increased risk, microenterprise lenders provide training and technical assistance to support borrowers and their businesses, and boost the capacity to operate the business and repay the loan. However, by supporting capital structures that may be up to 100% debt-based, microenterprise lenders may be restricting opportunities for the growth, experimentation, and coverage that fledgling businesses require in order to prosper. By integrating the IDA savings process into
microenterprise lending, organizations can help a micro-entrepreneur to develop a healthy capital structure that balances debt with equity, reduces the lender’s exposure to risk, and enhances a growing business’s chances of survival.

A variety of financial institutions, including credit unions, mainstream commercial lenders, and microfinance institutions working outside the U.S. have explored the integration of savings and credit instruments, particularly in the case of new clients. In evaluating business loan candidates, commercial lenders, including banks, traditionally turn to the Five Cs of credit analysis—character, capacity, capital, collateral, and coverage (Hunt, Williams, & Donaldson, 1976). Lenders look favorably on a candidate’s savings, which demonstrate capacity to repay the loan, as well as serve as equity in a capital structure that protects the lender’s exposure to risk. Banks will encourage small business loan candidates to open a Certificate of Deposit (CD) in their business’s name, either to secure the loan or to provide additional coverage in the case of emergency.

Credit unions operate in countries around the world to fulfill member needs for savings and credit. Membership in a credit union is defined by a “common bond,” a partnership of savers and borrowers, grounded in a community, organizational, or religious affiliation or an “employee-based relationship” (Branch & Evans, 1999, p. 2). Credit unions are authorized to mobilize both member and nonmember savings and loan out these internally generated funds to members. Although many organizations that specialize in microenterprise and microfinance have incorporated savings elements, credit unions are the only institutions that see savings as an equal partner to credit when promoting asset development in lower-income communities (Otero & Rhyne, 1994).
The Importance of Assets

Asset-based approaches to poverty alleviation assume that without assets, poor families will remain poor. In the United States, the distribution of assets, or wealth, is much less equal than the distribution of income. The top 1% of households control 90% of all assets, while 31% of American households have no or negative investable assets (Oliver & Shapiro, 1995). Nearly 61% of African American households have no or negative net financial assets, as compared to 25.3% of white households (1995). Sherraden (1991) points out that the U.S. already spends over $200 billion dollars annually on asset development by providing tax incentives for accumulating assets, specifically in accounts for housing and retirement-related expenses (Sherraden, 1991). However, 90% of these tax expenditures go to households earning over $50,000 per year, principally because the income and tax liabilities of LMI households are so low that tax deductions or deferments provide few incentives to save and acquire assets (Sherraden, 2000b).

Sherraden (1991), Oliver and Shapiro (1995), and others note that asset ownership helps households to set goals, realize dreams, stabilize families and neighborhoods, and improve their children’s lives. Moser (1998) highlights the importance of helping lower-income households build diversified portfolios of assets that insure them against “income shocks,” such as illness and termination of employment (1998). The lower a family’s income, the more devastating such a shock can become. Assets, in the form of savings, housing, equipment, or education, can serve as alternate income streams in times of need. Similarly, IDAs define assets in terms of human capital (skills, knowledge, and experience) and financial capital (property and financial holdings).

Individual Development Accounts

IDAs vary in structure, but are generally defined as savings accounts with proceeds restricted to the acquisition of high-return assets, such as housing, postsecondary education, and
business. The savings are matched at some rate, generally at $1 to $4 for every dollar saved. Participation is voluntary, but is restricted to LMI individuals through means and asset testing. Most programs include two training components: financial literacy education and training specific to the particular asset.

In 1997 the Corporation for Enterprise Development (CFED) partnered with the Center for Social Development (CSD) at Washington University in St. Louis to create the American Dream Demonstration (ADD), an extensive evaluation of 13 IDA programs across the United States. Support came from foundations, private companies, individuals, and state, local, and federal governments to leverage over $15 million in public and private funds (Corporation for Enterprise Development, 2001).

In 1998 the Assets for Independence Act (AFIA) passed under Title IV of the Community Opportunities, Accountability, and Training and Educational Services Act of 1998 (P.L. 105-285). AFIA authorizes IDA demonstration projects administered by the U.S. Department of Health and Human Services (HHS) at $125 million. The AFIA legislation asserts that "income-based domestic policy should be complemented with asset-based policy because, while income-based policies ensure that consumption needs (including food, child care, rent, clothing, and health care) are met, asset based policies provide the means to achieve greater independence and economic well being" (Assets for Independence Act, P.L. 105-285, 1998). Congress will consider reauthorization of the AFIA legislation in 2003.

A recent survey counted 511 IDA programs in operation in 49 states and the District of Columbia. Nationwide, at least 20,634 people are actively saving in IDAs and at least 5,177 people have graduated from an IDA program. Twenty-nine states have passed IDA-related legislation, and 40 states include the use of IDAs in Temporary Assistance to Needy Families (TANF) legislation (Corporation for Enterprise Development, 2002). American Dream Demonstration (ADD) data reveal
that, as of December 31, 2001, 2,364 families in the 13 ADD sites alone had saved $1,248,678 and leveraged another $2,399,470 in matching funds (Schreiner, Clancy, & Sherraden 2002). Twenty-eight percent of matched withdrawals were for home purchase, 23% for microenterprise, 21% for postsecondary education, 18% for home repair, and 10% for other purposes, such as retirement, and the balance for job training (2002).

The most recent CSD report suggests a profile of the IDA participants in ADD (2002). Participants are primarily working, female (80%), African American (47%) high school graduates (85%). The average monthly net deposit was $25.42 and the average account holder made a deposit seven out of every twelve months. The average participant accumulated approximately $900 per year in IDAs when deposits and matches are counted.

In order to expand the scale of IDAs, CFED convened a coalition of policymakers, financial institutions, academics, and community-based organizations to advocate for the Savings for Working Families Act (SWFA), which, if passed, would offer depository financial institutions tax credits to administer IDAs and contribute matching funds. If passed, the SWFA would distribute $450 million in tax credits, and create approximately 300,000 new accounts (Charity, Aid, Recovery, and Empowerment (CARE) Act, H.R. 7, as amended).

IDAs are now a decade old. They have been analyzed from a variety of perspectives (Beverly, Moore, & Schreiner, 2001; Beverly & Sherraden, 1999; Bosshara & Friedman, 1997; Clones, Friedman, Grossman, & Wilson, 1995; Edwards, 1997; Page-Adams & Sherraden, 1997; Sherraden, 1998). These studies consistently demonstrate that poor people can and will save. One study addresses the financial impact of ADD participation on net savings and assets (Stegman, Faris, & Urdapilleta Gonzalez, 2001). The authors find that IDAs have a small, yet significant, positive impact on net savings. The analysis indicates $117 more in savings for the median participant.
and $285 more in mean savings effect compared to what would have been saved without ADD.

IDAs for Microenterprise

IDAs have three primary uses: homeownership, education, and self-employment (microenterprise). Additional allowable uses are program or funder specific. As mentioned, microenterprise is one of the most common IDA uses chosen by participants. Microenterprise IDAs are intended for use in the capitalization of small businesses and may be restricted to the purchase of tangible assets. Account holders typically participate in core financial literacy training and some form of entrepreneurial training. IDA account holders are usually constrained to capitalizing very low entry costs and, presumably, low income potential businesses due to IDA savings limits. Many of the same community-based organizations that offer IDAs run microenterprise development programs, providing loans, training, and technical assistance to low-income entrepreneurs. Target populations include women, minorities, refugees, immigrants, and residents of lower-income communities and public housing developments.

Microenterprise Development in the United States

In the United States, microenterprise development is a relatively new field that traces back to the mid- and late 1980s. The main focus of MED is disadvantaged individuals who either operate or are considering starting microenterprise. MED programs arose at the confluence of several challenges in the U.S. society and its economy. These include a search for new methods of poverty alleviation; the need for nontraditional economic development strategies to rebuild impoverished communities; growth of the feminist movement and the roles of women in the work force and as business owners; a desire to resolve inequities in access to credit; and the need to assist pockets of high unemployment and displaced workers (Servon, 1999). MED has emerged as one strategy to assist in asset accumulation, poverty alleviation, community and economic
development, empowerment of disadvantaged populations, and improved access to credit.

The 1999 Directory of U.S. Microenterprise Programs includes 341 U.S. microenterprise programs in 46 states and the District of Columbia (Langer, Orwick, & Kays, 1999). There are 283 practitioner programs listed providing direct service to over 57,000 individuals in 1997 and a cumulative total of approximately 250,000 participants. Of the programs reporting establishment dates, 78% were formed between 1991 and 1999 (Langer, Orwick, & Kays, 1999). The MED field in the U.S. has grown considerably in a short period of time.

U.S. MED programs are strikingly diverse. They differ in their goals, strategies, target populations, size, and sources of funding. Microenterprise development programs are variously perceived as programs for poverty alleviation, economic development, community development, self-employment support, personal development, or access to credit. Institutions tend to fall into one of two categories: “credit-led” institutions that concentrate on enterprise financing, and “training-led” institutions that focus on providing micro-entrepreneurs with training and technical assistance. Target populations encompass low-income populations, women, racial/ethnic groups, recipients of public assistance, refugees and immigrants, public housing residents, people in targeted geographic areas, unemployed individuals, people in certain age groups, special populations, and credit constrained individuals and communities. Host programs have included community action agencies, women’s economic development organizations, and newly created organizations.

Microenterprise development programs also differ substantially in size, financial capacity, and structure. Capital funds for MED programs range in size from $5,000 to $12 million, with an average size of $738,626 (Langer, Orwick, & Kays, 1999). The average operating budget was $268,102 in 1997, with a range of $3,000 to over $1 million. The funding for these MED programs comes from a wide variety of sources.
including private donors, religious sources, foundations, governments, financial institutions, and corporations. Although the sources of funding are diverse, when compared with spending on other social and economic development strategies, the $70 to $100 million per year spent on MED is small (Else & Gallagher, 2001).

The emphasis of the research on microenterprise development to date has been the documentation of programs and the evaluation of their contribution to the alleviation of poverty. One of the few evaluations of MED programs that use control group methodology studied the impact of MED services on Unemployment Insurance (UI) claimants. This study, sponsored by the Department of Labor, found MED to be a cost-effective intervention, in that social benefits, increases in total earnings due to self, and wage employment over a 32-month period exceeded social costs (Bénus et al, 1995). The Aspen Institute’s five-year longitudinal study of microentrepreneurs, the Self-Employment Learning Project (SELP), included the following findings regarding the impact of MED programs on the subset of very low-income clients (Clark & Kays, 1999, pp. vii & viii):

- 72% increased their household income over five years by an average of $8,484 or from $14,889 to $22,374
- Average household assets increased by $15,909 over five years
- Over half—53%—moved above the poverty line; and
- Dependence on public assistance decreased by 61%.

Although microenterprise has been largely endorsed as filling an important gap in services for low-income people, a consensus has emerged that beneficiaries are a fairly small segment of the LMI population in the United States. As Mark Schreiner asserts, “Microenterprise does work for a few extraordinary low-income people, but wage employment, additional education, and job training are still the most common paths out of poverty” (Schreiner, 2000a, p. 2). Other social scientists and practitioners have expressed their own concerns about
microenterprise (Bates & Servon, 1996; Bhatt, Painter, & Tang, 1999; Else & Gallagher, 2001; Rogaly, 1996; Schreiner, 2000a; Servon & Bates, 1998).

The integration of IDA and MED services represents an opportunity to expand the scope and clientele of MED programs in the United States. By laying the groundwork and methodology for a systematic consideration of IDA savings in credit analysis, practitioners may be able to reach new, poorer clients and begin to explore a larger spectrum of financial services for low- to moderate-income households.

The Opportunity: Leveraging the IDA in Microcredit Analysis

Individual Development Accounts and microenterprise development are synergistic strategies for asset development. Participation in an IDA program involves a commitment to regular savings, to education in financial literacy, credit improvement and repair, and, in the case of microenterprise IDAs, to training in business planning and management. The IDA experience is one of “savings with education,” which increases both financial and human capital. As such, participation in an IDA program can improve a participant’s standing in light of the conventional 5 Cs of credit analysis: character, capacity, capital structure, collateral, and coverage. As illustrated in Figure 1, IDA participation holds explicit value from a credit perspective. Participation in financial literacy classes, credit education, and credit repair can endorse character through ultimate improvement in credit status. IDA training may improve the capacity of participants to operate a business and regular savings deposits demonstrate their capacity to repay business loans; IDA participation improves the capital structure of a business by providing increased equity in the form of participant savings and match funds; although largely unexplored, IDA savings could serve as collateral for a microloan (or any equipment purchased with the IDA could serve as collateral); and finally IDA savings could provide
Figure 1: Integrating IDAs and Loans for Microenterprise: IDAs as a Credit Enhancement

**Inputs: Human and Financial**
- **Human:** Financial literacy training, Asset-specific training, Technical assistance (business plan, financial management)
- **Savings Process:** 
  - **Financial:** Individual Savings Match $${}$$

**Outputs**
- Increased skills: Financial/business management; regular savings pattern
  - Cs: Character, Capacity
- Increased personal and business assets
  - Cs: Capacity, Capital, Collateral, Coverage

**Outcome:** Increased Creditworthiness
coverage or insurance for repayment in the event of an emergency. As suggested by Figure 1, participation in an IDA program results in improved creditworthiness for the individual and the business, as well as in the increased levels of household assets and self-sufficiency that all IDA programs promise.

Figure 1 provides a general logic model for integrating IDAs and loans for microenterprise, so that the savings process guided by IDA programs, and the increased human and financial capital produced, are valued in microcredit analysis. Table 1 illustrates this logic model by translating the elements of IDA programs into potential human and financial capital benefits from the perspective of credit analysis.

The balance of this paper offers a discussion of findings from our research and explores current and potential program and product models.

Research Methodology
The First State Community Loan Fund (FSCLF), with the support of CFED, used multiple methods to assess the current status of the integration of IDAs and microenterprise loans in organizations across the U.S., and to identify future opportunities for integration. First, a literature review was completed to enhance understanding of both microenterprise and asset-based strategies. Second, a written survey was sent to IDA and microenterprise programs. Third, programs that were self-identified as “linking” the two strategies were interviewed. Finally, three focus groups were held to gain insights from microenterprise program staff, IDA program staff, and microenterprise IDA account holders.

The written survey was distributed to 106 IDA and microenterprise program directors across the U.S. All IDA grantees under AFIA, ORR, and ADD as of September 1, 2001, received the survey. In addition, members of the IDA Network Listserv who self-identified as linking IDAs and microloans and one microloan program known to the investigators were surveyed. Program directors were asked questions about the
<table>
<thead>
<tr>
<th>IDA Aspect</th>
<th>Five Cs</th>
<th>Capital Type</th>
<th>Benefits from Microcredit Perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular savings over a 6-month to a 3-year period to reach a goal</td>
<td>Capacity</td>
<td>Human Capital</td>
<td>* Demonstrates capacity to manage finances consistently</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>* Time spent in IDA equal to time in business at preset proportion</td>
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<td></td>
<td></td>
<td></td>
<td>* Shows character and discipline</td>
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<td></td>
<td></td>
<td></td>
<td>* Increases capacity for more timely payments</td>
</tr>
<tr>
<td>Savings $5</td>
<td>Capacity</td>
<td>Financial Capital</td>
<td>* Provides owner’s equity</td>
</tr>
<tr>
<td></td>
<td>Capital Structure</td>
<td></td>
<td>* Reduces debt requirements</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>* Decreases liquidity constraint</td>
</tr>
<tr>
<td>Match $</td>
<td>Capital Structure</td>
<td>Financial Capital</td>
<td>* Provides owner’s equity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>* Leverages scarce resources</td>
</tr>
<tr>
<td>Financial literacy training</td>
<td>Capacity</td>
<td>Human Capital</td>
<td>* Creates and enhances understanding of how money works</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>* Increases capacity to manage business resources</td>
</tr>
<tr>
<td>Credit counseling</td>
<td>Character</td>
<td>Human Capital</td>
<td>* Strengthens credit record</td>
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<td></td>
<td></td>
<td></td>
<td>* Encourages progress on repairing credit problems</td>
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<tr>
<td>Entrepreneurship training/technical assistance</td>
<td>Capacity</td>
<td>Human Capital</td>
<td>* Decreases need for training technical assistance within microloan program</td>
</tr>
<tr>
<td>Business plan development</td>
<td>Capacity</td>
<td>Human Capital</td>
<td>* Improves preparation and articulation of business concepts, plans, and needs</td>
</tr>
<tr>
<td>Support groups</td>
<td>Capacity</td>
<td>Human Capital</td>
<td>* Build social capital and trust</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>* May provide a strong substitute for peer groups</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>* Foster additional character and capacity for repayment</td>
</tr>
<tr>
<td>IDA at an insured financial institution</td>
<td>Character</td>
<td>Financial Capital</td>
<td>* Develops a banking relationship and overcomes privacy issues and fear of formal institutions</td>
</tr>
<tr>
<td></td>
<td>Coverage</td>
<td></td>
<td>* Opens potential credit repair opportunities to reduce risk</td>
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<td></td>
<td>Collateral</td>
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design, content, requirements, and funding of their programs. Those programs that offered both IDA and MED services were asked if they linked the services in any way, including giving special consideration to IDA participants seeking loans. A total of 71 usable responses (67%) were received and analyzed.

Sixteen programs that self-identified as pursuing connections between IDA and MED were interviewed between May and August of 2002 by FSCLF staff. Profiles of these programs were developed for separate dissemination.

Finally, in order to delve more deeply into the benefits and challenges of integrated program and product design, CFED staff conducted three focus groups in Wilmington, Delaware, during July of 2002. The focus groups included IDA and MED program staff and microenterprise IDA account holders. The first group included five professional staff from the Capital Works™ microenterprise program, a statewide program that, since its inception in 1995, has issued over 550 loans and served in excess of 2,000 customers through training, technical assistance, and access to markets. The staff members were drawn from Capital Works™ program partners, the FSCLF, and the YWCA of New Castle County. The second focus group was composed of five program managers and staff from the sites involved in Delawareans Save!, the statewide IDA collaborative, a 2001 AFIA grantee. Delawareans Save! sites include a social services agency, a housing counseling agency, a community action agency, and a faith-based CDC. The final group included seven microenterprise IDA account-holders from Delawareans Save!

Multiple research methods ensured increasing depth of understanding and triangulation of results. However, it is important to note that the sampling approach focused on year 2000 IDA grantees under the three major funding sources that exist (AFIA, ORR, and ADD). Organizations that received IDA grants from these three sources since 2000 and organizations with other sources of IDA funding were not included in
this study. As we mention below, more comprehensive research is needed to produce recommendations.

Findings: National Results and Program Activities

While a number of interesting findings emerged from the national survey of program managers, the most remarkable result was that while 89% of respondents report providing both IDAs and MED services, only 22.5% of survey respondents report making any form of explicit connection between IDA and microenterprise strategies. Although the majority of IDA programs offer homeownership IDAs that result in home mortgage loans, very few respondents have explored providing increased access to business loans for participants with microenterprise IDAs. Unlike the case of homeownership, microenterprises do not always require relatively large infusions of up-front capital. However, with IDA savings and matching funds capped at a maximum of $5,500 among respondents, one would think that the demand for additional enterprise capital among microenterprise savers might have produced more explicit connections with credit facilities, especially among facilities in the same organization.

According to the Aspen Institute's forthcoming 2002 Directory of U.S. Microenterprise Programs, 67 out of 308 programs (21.8%) offer IDAs (Walker and Blair, 2002). Due to this survey's response rate (60.6% of known programs) and incomplete responses, these results may represent a significant undercounting of MED programs offering IDAs. What these data do demonstrate is that microenterprise programs have begun to offer IDAs, and that they may be linking their savings and credit facilities at some level. Further research on such relationships is needed.

Program and Product Integration

There is a range of opportunities to integrate IDA and microenterprise strategies, at both the levels of program and product design. The goals, target populations, and funders of
the two strategies overlap considerably, indicating a strong potential for programmatic synergy. The data shows that there are IDA programs that offer MED services and MED programs that offer IDAs, and the interest in each is growing. Survey respondents assert that integration can benefit both IDA and MED program participants. Microsavers can leverage savings to access additional capital in the form of credit, and microborrowers can improve financial literacy and access to equity infusions and other resources.

This study's results demonstrate that there is an "integration spectrum," which ranges from "low integration," which generally consists of basic coordination, the referral of participants from one program to the other; to "medium integration," the integration of programs, whose very design, training, and staff resources maximize synergies and participant transition; to "high integration," which complements an integrated program design with the integration of IDA and microcredit products, such that IDA participation (financial and human capital) is explicitly valued in the underwriting of a microenterprise loan. This spectrum is often, but not always, cumulative, so that programs move from low to high degrees of integration. "High integration" is not for everyone and depends very much on the individual needs of a target market and organizational core competencies. The next section provides examples from the study that illustrate the various points along this integration spectrum.

Illustrating the "Integration Spectrum"

The study followed up the national survey with in-depth interviews of those 16 organizations that reported some "connection" between IDA and MED programs. Eleven of these organizations provide MED training and lending services and microenterprise IDAs using in-house staff and resources. The other five organizations offer some combination of IDA and MED training, technical assistance, and financing through
collaboration with partners. The 16 organizations differ in programmatic mission, target population, legal structure, and funding sources. They include microlenders, community development financial institutions (CDFIs), 6 refugee service agencies, social service agencies, a community development credit union, and an international relief organization. Using the data gathered during in-depth interviews with the 16 “linking” programs, Table 2 describes these organizations in terms of internal and external provision of the various IDA and MED program components. “Internal services” refers to those services that organizations provide in-house with their own staff or resources. “External services” refers to those services provided through collaboration with partner organizations. The table also documents the degree to which IDA savings and microcredit products are integrated, and the nature of the value, if any, assigned to IDA participation. In terms of the value or “reward” for IDA participation, responses fell into one of the following categories:

- None: no value
- Automatic qualification for a loan equal to the amount saved
- Equity requirements fully to partially satisfied by IDA savings
- Collateral requirements fully to partially satisfied by IDA savings
- Increased eligibility: IDA participants are more likely to qualify for a loan. In those programs where IDA participants automatically qualify for loans equal to the amount saved, “increased eligibility” refers to the increased probability that they will qualify for larger loans
- Loan terms: IDA participants received more favorable loan terms, such as reduced interest rates or longer loan terms.

Table 2 highlights a number of interesting characteristics of current integration practice. There does not seem to be a
### Table 2. IDA and MED Service Provision

<table>
<thead>
<tr>
<th></th>
<th>External Services</th>
<th>Internal Services</th>
<th>Reward for IDA Participation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Financial Literacy</td>
<td>MED Training</td>
<td>Lending</td>
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<td>ACCION Texas</td>
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<td>(San Antonio, TX)</td>
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<td>Advocap</td>
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<td>(Oshkosh, WI)</td>
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<td>Women’s Initiative for Self-employment (San FRancisco, CA)</td>
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particularly high degree of association between internal provision of MED and IDA services and “rewarding” IDA participation in credit analysis. For example, organizations with strong partnerships with credit facilities may have equal success in implementing such credit enhancements as those that administer loans themselves. This issue warrants further exploration.

The most common “reward” given to IDA participants during the credit analysis or underwriting process is increased eligibility for a microenterprise loan. Participants with IDA experience are more likely to be approved for microenterprise loans. Requirements may be reduced or waived and loan applications are given “special” consideration. The next most common rewards for IDA participation are: decreased equity requirements, in that IDA savings and match funds contribute towards that requirement; automatic qualification for a microenterprise loan equal to the amount saved; and more favorable loan terms (such as reduced interest rates or extended terms). Organizations seem much less likely to treat IDA savings as collateral. Only one MED program, ACCION-Texas, treats IDAs as sources of collateral. However, this organization only admits into their program individuals who have previously qualified for microenterprise loans.

The following section includes profiles of three organizations that represent the various phases of the integration spectrum.

**Low Integration**

The New York Association for New Americans, Inc., (NYANA) in New York City offers programs to aid refugees in their efforts to achieve financial independence. Programs in NYANA’s Business Center provide microloans, financial literacy training, and IDAs. They also provide referrals to other microlenders and financial institutions. NYANA’s MED program serves all foreign born individuals. However, only
refugees, those with asylum, and Haitian and Cuban entrants may enroll in the IDA program. IDA savings may be used for microenterprise, homeownership, postsecondary education, home repair, or computer purchase.

NYANA requires microenterprise clients in its IDA program to attend eighteen hours of Management Training workshops, which include instruction on how to write a business plan and six hours of training on money and assets, all of which are conducted by NYANA staff. Clients also receive business counseling and complete a two-page business plan and financial projections. No special underwriting considerations are given for IDA savers in the microloan program. However, some microloan customers have enrolled in IDAs subsequent to enrolling in the MED program.

NYANA receives funding from the Office of Refugee Resettlement (ORR).

Medium Integration

In keeping with the Jewish tradition to help one's community, Jewish Family Services (JFS) of Columbus, Ohio, provides social services to individuals and families of all backgrounds. JFS offers MED, IDA, and financial literacy training programs for both low-income and refugee populations in the Greater Columbus Metropolitan area and assists participants in building relationships with local banks. IDA savings may be used for microenterprise, homeownership, postsecondary education, home repair, transportation, or computer purchase.

Participants in the IDA program must attend four two-hour training sessions, and microenterprise clients must complete and submit a business plan before receiving matching funds. The microenterprise IDA program at JFS is linked to a microloan program. IDAs are treated as credit enhancements, and IDA clients receive technical assistance. Microenterprise clients are encouraged to save in IDA accounts.

JFS is funded by various institutions, including the ORR and several banks.
High Integration

IDA-EDG, housed at the Ethiopian Community Development Council, Inc., in Arlington, Virginia, focuses primarily on asset building for refugees. IDA-EDG provides IDAs, financial literacy, and MED training in-house and partners with other organizations for the provision of microloans. IDA-EDG savers may use IDA savings for microenterprise, homeownership, postsecondary education, home repair, transportation, or computer purchase.

IDA clients of IDA-EDG must attend five two-hour classes in financial literacy and asset building. IDA savers automatically qualify for microloans. These loans are available to IDA participants at a reduced interest rate. IDA funds may also be used to fulfill equity requirements for microloans.

This program is funded through the ORR.

The mission of the Justine Petersen Housing & Reinvestment Corporation (JPHRC) of St. Louis, Missouri, is to match institutional resources to the needs of LMI families. JPHRC is an SBA intermediary lender that specializes in asset development and housing programs. JPHRC provides financial literacy training, MED training, and microloans in-house. JPHRC offers IDAs for the purposes of microenterprise, homeownership, transportation, home repairs, or postsecondary education.

JPHRC offers two tracks of training for MED and IDA programs, both of which focus on "loan readiness." Clients in the "Fast Track" program prepare business plans with minimal assistance from a loan counselor. In the "Technical Assistance Track," JPHRC counselors assist clients to complete a business plan questionnaire, market analysis, and cash flow projections. At JPHRC, participation in the IDA program is correlated with approval of a microloan application. For savers with a low level of readiness, the IDA program creates and reinforces savings habits to ensure a buffer for cash flow issues. IDAs provide an initial equity capital injection of $600 to $900 after six months, including savings and match funds, into businesses,
and help JPHRC establish relationships with potential borrowers. After six months, IDA participants with a moderate level of readiness qualify for a Step loan of $500 to $2,500. A “Next Step” loan of $2,501 to $5,000 is available, based upon the borrower’s ability to repay the first loan and to save in the IDA program. For those with a high level of readiness, IDAs are paired with microloans and borrowers receive matching funds without restrictions.

JPHRC receives funding from the United Way of St. Louis, HHS, AFIA, and Missouri State Tax Credits.

Table 3. Four Representative Organizations

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<tr>
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<th>NYANA</th>
<th>JFS</th>
<th>IDA-EDG</th>
<th>JPHRC</th>
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<tr>
<td>IDA Income Eligibility</td>
<td>At or below 200% of poverty</td>
<td>At or below 200% of poverty</td>
<td>At or below 200% of poverty or 80% area median</td>
<td>At or below 200% of poverty</td>
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<tr>
<td>IDA Match Rate</td>
<td>2:1</td>
<td>2:1</td>
<td>2:1</td>
<td>2:1 (general) 1:1 (median)</td>
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<tr>
<td>Maximum Match $</td>
<td>$2,000/Individual $4,000/Household</td>
<td>$2,000/Individual $4,000/Household</td>
<td>$600 Annually</td>
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<tr>
<td>Cumulative Microenterprise IDA Accounts</td>
<td>41</td>
<td>183</td>
<td>11</td>
<td>75</td>
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<tr>
<td>Cumulative IDA Savers with Microloans</td>
<td>9</td>
<td>15</td>
<td>1</td>
<td>Approx. 30%</td>
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Preliminary Observations

Given that the integration of IDAs and microenterprise is nascent, it is difficult to offer conclusions or recommendations with confidence at this point. We have merely introduced the concept, a framework for valuing IDAs in microcredit analysis, and the state of current practice. We recommend further research. Recognizing the small sample size and preliminary nature of the data, we make some initial observations and tentative recommendations:

- A number of organizations have made the link. Nine out of the sixteen organizations that were interviewed have taken explicit steps to reward IDA participants with increased creditworthiness. In some cases, managers indicated a desire or intent to make a more explicit connection.
- Integration is not for everyone. Depending on an organization's target market, microentrepreneurs served may prefer to save for their businesses rather than accumulate additional debt. Some program managers cited the need to give everyone an "equal opportunity" to access a loan, and rejected the idea of "privileging" IDA account-holders. Still others cited funding requirements as a barrier to integration.
- One size does not fit all. Some program managers assert that IDA participation should be mandatory for potential microborrowers. Others merely think that aspiring borrowers should be rewarded for creditworthy behavior at the end of the day. Still others cited the IDA savings process and integration itself as a way to level the "borrowing playing field." Depending on the risk tolerance of the organization, a microloan may be provided up front or only after successful completion of the IDA program. IDA participation may fulfill or decrease loan requirements. Or it may have no effect.
- Integration goes both ways. Although we have focused on bridging the gap between IDAs and microloans for IDA savers, there is some evidence that microborrowers also benefit from entering IDA programs, which can improve both human and financial capacity; the human capacity to
operate the business and the financial capacity to repay the loan. Microborrowers can access the equity missing from their businesses' largely debt-dependent structures. Lenders benefit by decreasing their own exposure to risk.

Conclusion

It has become increasingly clear that low-income entrepreneurs, like their higher-income counterparts, need a variety of financial and nonfinancial services to support and enhance their businesses. Like mainstream financial institutions, organizations providing IDAs and microenterprise services are beginning to test the benefits of integrating savings and credit instruments. There appear to be institutional benefits that come in the form of decreased exposure to risk and, potentially, increased loan volume with minimal underwriting costs. There are a variety of potential customer benefits, including increased credit-worthiness, decreased transaction costs, and healthier capital structures for enterprises.

In order to fully test these potential benefits, further research must be done to measure a number of institutional and individual indicators. We recommend that studies be undertaken to measure the impact of integration on,

- Recruitment and retention of participants
- Participant transaction costs
- Targeting of lower-income populations
- Performance of microenterprise loans
- Loan volume
- Program costs per outcome (business started, loan deployed)
- Business sustainability and performance
- Household self-sufficiency and asset holdings

Barriers to integration should also be examined in more detail.

By quantifying the impact of the various IDA components on variables such as loan performance, this research will inform a growing discussion of systematic risk assessment in microfinance. Some microenterprise lenders have begun to
implement credit-scoring models that help to predict the risk profile of a loan applicant based on certain traits that are associated with repayment of a loan (asset ownership, employment, and so forth). If it is determined that participation in IDA training and saving is correlated with higher loan repayment rates, these components can be explicitly incorporated into risk profile definitions through positive scoring, possibly enabling applicants to compensate for poor credit histories.

Microenterprise development is a maturing field in the United States. MED programs are exploring the range of asset development services that serve the needs of lower-income clients. By diversifying and integrating products and services such as IDAs and microloans, MED organizations can grow to become operations that more accurately reflect the realities of the people they serve and thus expand the reach and impact of this industry in the United States.

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Savings and Credit for U.S. Microenterprises


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Journal of Microfinance


Notes

The authors would like to thank Lisa Spellman, Abigail Horn, and Christopher Holmes for their valuable research assistance.

1. Microenterprise development in the U.S. is defined as financing, training, mentoring, counseling, and other kinds of technical assistance provided to individuals starting or operating a business that generally employs less than five people, or that can use a loan less than $35,000.

2. Loans for microenterprise are generally designed for investment in working capital or equipment. We will also refer to microenterprise loans as "microloans."
3. IDA programs may serve households receiving TANF benefits; Earned Income Tax Credit (EITC) eligible households; households below 80% of Area Median Income (AMI), 200% of the federal poverty line, and others. Sometimes these income guidelines are paired with asset limits, so that participants qualify on the basis of income and assets at the time they begin asset accumulation. Programs also have other explicit and implicit target markets based on mission, community needs, and funding parameters.

4. Note that ADD limits the amount of match to $500 per year per individual.

5. Not unlike the "credit with education" model endorsed by microfinance organizations, such as Freedom From Hunger, around the world.

6. CDFIs are specialized financial institutions that work in market niches that have not been adequately served by traditional financial institutions. These CDFIs provide a wide range of financial products and services, including mortgage financing for first-time home-buyers; financing for needed community facilities, commercial loans and investments to start or expand small businesses, loans to rehabilitate rental housing, and financial services needed by low-income households and local businesses. In addition, these institutions provide services that will help ensure that credit is used effectively, such as technical assistance to small businesses and credit counseling to consumers. CDFIs include community development banks, credit unions, loan funds, venture capital funds, and microenterprise loan funds, among others. (CDFI Fund: http://wwwCDFIfund.gov/overview/index.asp)

7. Community development credit unions (CDCUs) are credit unions with a mission of serving low income people. Like all credit unions, they are nonprofit financial cooperatives, owned and operated by and for their members. CDCUs also have a strong commitment to serving the broader community. They demonstrate that commitment through community outreach, through participation in government programs, through partnerships with the private-sector in community revitalization efforts, and by their collaboration nationally with other members of NFCDCU (National Federation of Community Development Credit Unions: http://www.natfed.org).
A Symposium on
Savings-Led
Microfinance and the
Rural Poor

Introduction by Jeffrey Ashe

Preface

Microfinance has achieved much in the twenty years since it became recognized as an important tool of development, but the demand for credit and savings services far exceeds the current institutional capacity. While microfinance institutions effectively deliver services to cities and densely populated rural areas, they have had limited success serving rural areas more than a few kilometers from urban centers. In only a few countries—Indonesia, Bangladesh, and Bolivia, for example—has microfinance reached a sufficient number of clients to make a difference on a national scale. How can the rest be reached? The answer may be already before us.

While only 11% of the world’s 235 million poorest families are served through microfinance institutions worldwide (Daley-Harris, 2002, p. 14) ROSCAS (Revolving Credit and Savings Societies)—Tontines, Susus, Chit Funds, Merry Go Rounds, Tandas—and other locally controlled organizations exist in virtually every village. What would happen if these groups were “modernized” into effective locally controlled savings and credit groups? Taking this another step further, what would happen if these groups with their empowered and prospering members became platforms for literacy, health education,
business literacy, and sustainable agriculture training, or even candidates for bank financing?

The programs from Nepal, Niger, India, Mexico, and Bangladesh profiled in this symposium on "Savings-Led Microfinance" are accomplishing exactly that. Instead of creating new microfinance institutions, locally controlled self-help groups are being trained to mobilize their own savings, manage their own accounts, and make loans at interest to their members. Since the issue is defined as group strengthening, not credit delivery, the standard microfinance paradigm has been turned inside out. In addition, savings-led programs build equity within the group rather than debt to an MFI and the interest paid on the loans contributes substantially to building the group's fund. When a woman leaves her group, she takes her savings and the interest her savings generated with her. All this is occurring in rural settings where a $30 loan is substantial, where a dollar a day would represent a tripling or more of per capita income, and where literacy rates are very low.

By sidestepping the costly and problem-fraught issue of managing an external loan fund, and by encouraging local NGOs and even group leaders to take the lead in training and monitoring these groups, the process of expansion is greatly simplified, highly decentralized, and very inexpensive. It becomes feasible to involve local partners in large numbers because there is no credit delivery infrastructure to manage, and the potential for fraud at the staff level is minimized since each group manages its own fund. Another advantage is that if the local institution supporting the groups fails, the groups can continue on their own once they are trained.

In these programs, training is often provided by animators or promoters with minimal formal education who are recruited locally, know local languages and customs, and are paid at local rates. Within two to three years, the leaders of

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these groups, who are typically women, have shown their initiative by starting new groups in response to requests for help from nearby villages, and some have become independent agents paid by the groups they start and monitor. This further reduces costs and the need for external funding while increasing the rate of expansion.

Depending on the country, the local setting, and whether or not literacy or other training is included, these programs show that groups can be trained and monitored at a cost of $5 to $30 per member. Most of these costs are incurred during the eight months to three years it takes to train a group to operate independently. In contrast, the start up costs of a typical MFI can reach $300 or more per borrower, including the costs of capital, operations, systems, and training. Even efficient MFIs struggle to reach more remote areas; the fixed costs of lending and collection are simply too high. The savings-led models, however, can accommodate the needs of very small businesswomen in rural locations who may only take periodic loans that are tailored to their business size and specific needs as approved by their group.

The impact on clients is substantial. As group members save and borrow and manage their groups, they gain status in their families and become more active in their communities. As their assets and income increase, they start or grow their often agriculturally based income-generating activities, break free from moneylenders, and send their children to school.

The savings-led programs profiled here,

- Differ from credit unions because record keeping is simpler. Groups are much smaller and often build on existing local organizations or ROSCAS. They operate below the regulatory radar, scope and savings and lending policies are adapted to fit local conditions.
- Differ from traditional ROSCAS, since members deposit their money in a group managed fund that is lent to members at interest. Improved record keeping, monitoring, transparency, and auditing mitigate risks and the possibility...
of fraud within the groups, and trained groups often serve as platforms for the introduction of literacy, business training, health education, and other development inputs.

- Differ from MFIs because there is no external loan fund; savings and lending are managed entirely by the group.
- Differ from credit unions and banks that deliver microfinance services through their own staff, since the groups are generally trained and monitored by local NGOs, not the credit providing institution.

There are certain limitations to this methodology, however. Savings-led microfinance is best suited to "horizontal expansion"—the creation of very large numbers of simple autonomous groups. This makes it difficult to introduce new products such as insurance, and the limited size of each group's fund means that those who need more capital will not have access to it (except in India where groups can link to bank credit after demonstrating good performance as savings and lending groups). The methodology is also time-consuming, especially for the leaders. Grouping large numbers of self-help groups into federations is also risky because of the possibility of fraud when funds are not tightly controlled and group treasurers lack the training and sophistication to manage larger structures such as federations. Finally, groups might disband if other credit sources become available, but this point is academic; in the poor rural areas where these programs operate, there are no other sources of credit available.

This collection of articles is suggestive of the range of savings-led methodologies and also the universality of this approach, but like any new methodology, there is still much that needs to be learned:

- What are the most effective ways of developing groups?
- Under what conditions is each methodology most appropriate?
- How sustainable are these groups and what issues emerge as groups have larger funds to manage?
- Who joins and who is left out?
- How can fraud within the groups be controlled?
How can these groups be best used to introduce other development inputs?
• How can new initiatives be started and how can existing initiatives be expanded exponentially?
• What is the impact at the level of the individual and the community and how does it compare with the credit-led alternatives reaching this population?

A systematic investigation of the profiled programs and others like them will help answer these questions.

Although the number of savings-led programs is small, and there are many questions yet to be answered, it is important to consider that all major innovations in microfinance—including solidarity group lending, village banking, and commercialization—started with a few scattered efforts. Over a few years, these scattered projects inspired a globe spanning process of innovation and replication.

With interest in funding microfinance from donors waning and questions about microfinance reaching the poor increasing, a methodology that can reach several times more clients per dollar of donor subsidy becomes very attractive. This investment becomes even more relevant when it is considered that the NGOs can also use the groups to introduce other crucial development inputs including literacy, health education, and sustainable agriculture in order to improve the standard of living in these communities in the face of growing population and dwindling resources. With further study, training, and financing, savings-led microfinance could rapidly evolve into an important tool for helping achieve the Microcredit Summit’s objective of reaching 100,000,000 million of the world’s poorest by 2005.

Introduction to the Case Studies
The impressive scale and the low cost of the savings-led initiatives profiled in this symposium underscore the potential of this highly decentralized model.

PACT’s Women’s Empowerment Program (WEP) in Nepal operated through 6,500 groups with 130,000 members. These groups mobilized nearly $2,000,000 of assets in less than three years with 94% on loan to 45,000 group members. By mid 2001, WEP had as many outstanding loans as CARD in the Philippines and Compartamos in Mexico, two very well known “credit-led” microfinance institutions, while working through three times as many groups. In addition, 65,000 group members learned to read through Pact’s innovative curriculum that focused exclusively on managing a group, starting a business, and women’s empowerment.

WEP was implemented by 240 partners (most of them local NGOs) who were responsible for recruiting the groups and monitoring their performance. Local partners were working with almost all of the 6,500 groups within 60 days of startup, showing how quickly NGOs with their detailed knowledge of local communities can build a program if provided good training and support. The cost per client was $27.20, which included the costs of curriculum development, publishing, and the distribution of the four volume set to the 130,000 members, but did not include overhead and PACT’s Washington office expenses. With the end of AID funding, the WEP team was withdrawn from the field in May 2001. Although there are few reports of groups failing, further investigation will be required to see if groups continue to operate on their own with only the support of the local partners.

Hugh Allen, William Grant: “CARE’s Mata Masu Dubara (Women on the Move) Project, Microfinance for the Rural Poor that Works.”

CARE’s Mata Masu Dubara (Women on the Move) is serving 162,128 women organized into 3,654 stand-alone groups in the rural areas of Niger, one of Africa’s poorest countries. These
groups manage $3,000,000 of savings with virtually all of it on loan to members. Five hundred trainers selected by their communities and trained by the CARE staff monitor the groups and develop new ones. The group members themselves pay for these services. Sustainability, then, is achieved through fees paid by the groups, rather than interest charged to an MFI. Virtually all of the groups created over the last several years are still functioning, dropout is minimal and loan repayment is nearly perfect.

According to the State of the Microcredit Summit Campaign Report, 2002, MDD is the second largest microfinance initiative in Africa (p. 21), and very likely the only one that depends entirely on internally generated group controlled savings. Costs per client are estimated at $18 to $25 per member when training is carried out by the CARE staff, but drop to $3 per client when local facilitators do the training.


Indian NGOs have created at least one million self-help groups with 17,000,000 members since the self-help group concept was developed by MYRADA in the late 1980's. India is unique in that banks are permitted to lend directly to unregistered self-help groups and by May 2001, banks and cooperatives had financed 461,478 of these groups, with almost 200,000 new self-help groups financed between May 2000 and May 2001, indicating the accelerating process of expansion.

The National Bank for Agriculture and Rural Development (NABARD) trains the banks and refinances their loans. The key to NABARD’s success is decentralization. Responsibility for group development and training is devolved to NABARD’s 2,100 NGO partners and almost 450 banks and cooperatives provide banking services to the groups. According to the Microcredit Summit Report (p. 22), 2,663,901 of the 6,651,701 active members of the groups financed by through NABARD (most of them women) were categorized as “the poorest,” making NABARD the largest microfinance
initiative in Asia, with the Grameen Bank a close second. (If the number of members not linked to bank financing are included, the number of the poorest being reached through self-help groups is at least double that number.) Local costs range between $4 and $12 per member to train and support a group until it can operate independently.

Gabriela Zapata: “Community Savings Funds: Providing Access to Basic Financial Services in Marginalized Rural Areas of Mexico.”

Showing that savings-led microfinance is not only an Asian and African phenomena, the Mexican Government has underwritten the training of 540 Community Savings Funds with 12,800 members since mid-2000 and plans to expand this number to 20,000 groups with 600,000 members over the next several years. Each CCF mobilizes its own savings and manages its own loan fund, similar to the other self-help group initiatives.

Considering that only four percent of the eight million economically active population living in the rural areas of Mexico have access to financial services from banks, nonbank financial institutions, or government agencies, the potential to develop this market niche is great. (There is likely to be a similar demand for these services in other poor Latin American countries.) The cost for training a group averages $31 per group member and includes the fee to the promoter, transportation, and a model kit that presents all the systems needed to manage a group. Promoters are paid on a per-group basis. The costs for recruiting, training, and supporting the promoters are an additional cost.


Ashrai is getting good results with a savings-led model among minority peoples in northwest Bangladesh. Group members are mostly landless and illiterate, and earn about $50 per year. Ashrai began its field work ten years ago by replicating the Grameen Bank, but rapidly learned form its clients that they
Introduction to the Symposium

needed savings at least as much as loans, flexible repayment schedules structured around seasonal cash flow, and the easing of the requirement that loans be for productive purposes.

Ashrai operates through 3,100 groups with 55,000 women members, who have saved nearly $1 million of their own capital. As each group builds its capital base, its vulnerability to land loss, drought, and moneylenders drops dramatically, and members invest more in productive activities and education for their children. They hire and oversee their own bookkeeper and managing their finances without external support. It costs Ashrai $18 per member to support group development during the incubation period, considering all costs.

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PACT's Women's Empowerment Program in Nepal

A Savings- and Literacy-Led Alternative to Financial Building

by Jeffrey Ashe
Lisa Parrott

Abstract: Pact's Women's Empowerment Program (WEP) in Nepal operated through 6,500 groups with 130,000 women members. These groups mobilized nearly $2,000,000 of assets in less than three years with 94% on loan to 45,000 group members. By mid 2001, WEP had as many outstanding loans as CARD in the Philippines and Compartamos in Mexico, two very well known "credit-led" microfinance institutions, while working through three times as many groups. In addition, 65,000 group members learned to read through Pact's innovative curriculum that focused exclusively on managing a group, starting a business, and women's empowerment. WEP was implemented by 240 partners (most of them local NGOs) who were responsible for recruiting the groups and monitoring their performance. Local partners were working with almost all of the 6,500 groups within 60 days of startup, showing how quickly NGOs with their detailed knowledge of local communities can build a program if provided good training and support. With the end of AID funding, the WEP team was withdrawn from the field in May 2001. Although there are few reports of groups failing, further investigation will be required to see if groups continue to operate on their own with only the support of the local partners.
Introduction

I was first introduced to PACT’s Women’s Empowerment Program (WEP) during a meeting at Brandeis University, where I now teach. When Dr. Marcia Odell, PACT’s Chief of Party, took the podium, she explained that WEP was reaching 6,500 savings and credit groups with 130,000 women members in rural Nepal since its field operations had started only one year earlier. As most programs are fortunate if they reach 3,000 clients in their first year, there was clearly something important to be learned from WEP. After some lobbying, PACT agreed to send me to Nepal. I was to return twice more the following year.

What I learned about WEP challenged virtually every assumption I had developed over more than 20 years of working in microfinance. I began to appreciate that WEP’s goal was not to create a permanent and sustainable financial institution—it didn’t even have a loan fund. Its goal was to serve as what can be best described as a time limited catalyst of group development with the objective of helping thousands of groups evolve into well-managed, member-controlled savings and lending institutions with literacy training as a fully integrated and central component. Instead of groups or individuals borrowing from a central facility, each group loaned its own savings to its members (and sometimes to other villagers) with the interest paid to the group and the savers, rather than to an MFI. This was village banking, but without the external loan fund and without the rules and rigidity of the standard village bank model.

With USAID funding for WEP coming to an end and the impending withdrawal of the WEP team from the field, my final assignment was to carry out an evaluation to measure...
group performance and the program’s impact on the members. Lisa Parrott, a technical advisor in Microfinance from Freedom from Hunger, joined me in the evaluation. USAID’s Office of Microenterprise Development, Freedom from Hunger, the Overbrook Foundation, and SEEP jointly funded the study. USAID underwrote the costs of collecting 200 group interviews, using an instrument designed by the team leader, and 500 individual questionnaires using the AIMS Impact tool.

This report is divided into three sections. The first describes the WEP “savings-led” methodology and contrasts it with “credit-led” microfinance institutions (MFIs). The second section briefly summarizes the data from the two surveys that review the progress made by the savings and credit groups and the impact on the group members. The third section presents recommendations and conclusions and speculates on the implication of the WEP model for the microfinance field.

The WEP Model

WEP created a microfinance model based on building equity in the groups, rather than incurring debt to a Microfinance Institution (MFI), and was similar in spirit to the early credit unions. There were some critical differences, however, that help explain the success of the groups. The WEP groups were smaller than typical cooperatives (21 members); they operated completely below the regulatory radarscope; the model was much simpler and was based on village banking and local savings and credit group traditions; there was no injection of external capital; literacy training was built in; leadership was from within the group; and all the members were women.

Another factor explaining the success of the program was the literacy curriculum PACT used to train the groups. The four books used dealt exclusively with WEP’s objectives—group strengthening, business development, empowerment, and community activism—and provided members the essential information they required for success in each of these areas,
which helped insure the success of the groups. One of PACT's innovations was to use literacy volunteers, usually one of the group members, to run the classes rather than hire an instructor. This was a major cost savings. Other literacy programs in Nepal used paid instructors.

WEP was time limited in that it had less than four years of funding for curriculum development and for training the groups. It was a catalyst of group development because WEP worked through thousands of community groups—set up for literacy programs, irrigation, and many other purposes—that were recruited into WEP by 240 NGOs, cooperatives, and MFIs selected, trained, and monitored by WEP (many new groups were created as well). These 240 local organizations and WEP jointly trained and supported the groups and the local partners, who received a stipend for their assistance. Using existing community groups and developing systems to operate effectively and efficiently through large numbers of local partner organizations were the hallmarks of the WEP model.

The Two Microfinance Models Compared

By focusing on training groups rather than creating an institution to deliver credit, WEP has developed a useful alternative to the standard microfinance model. Over the past decade, microfinance has evolved rapidly in the direction of ever larger, more centrally controlled and better managed institutions to reach scale, cover costs, and even evolve into commercial financial institutions. WEP has also reached substantial scale, but by taking exactly the opposite approach: almost complete decentralization and local control. The objective was to create strong autonomous groups rather than create a permanent financial institution.

WEP was successful in large part because each partner was asked to do only what it was capable of doing. In WEP, NGOs were not asked to become MFIs; they were asked to recruit groups, distribute materials, and provide support and some basic training—activities that an average local NGOs can carry out successfully. Also, because there were no loans to
Table 1: Savings- and Credit-Led Approaches

<table>
<thead>
<tr>
<th>PACT's Women's Empowerment Program (WEP)</th>
<th>Typical Village Bank or Solidarity Group Program</th>
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<tr>
<td><strong>Basic Assumption:</strong> The poor can meet most of their credit needs through internally generated savings.</td>
<td><strong>Basic Assumption:</strong> Microentrepreneurs need access to credit to build their enterprises or meet their other needs. Credit is primary; saving is additional. (There is often no savings component.)</td>
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<td><strong>Institutional Objective:</strong> Serve as a time limited catalyst to create large numbers of independently functioning, locally controlled savings and credit groups.</td>
<td><strong>Institutional Objective:</strong> Create a permanent financial institution that delivers credit on an ongoing basis.</td>
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<td><strong>Ancillary Objective:</strong> Create literate and empowered members who will take a more active role in their families and community.</td>
<td><strong>Ancillary Objectives:</strong> Range from credit delivery only to using groups as a platform to introduce health, business training, and other services.</td>
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<tr>
<td><strong>Institutional Challenge:</strong> Develop an appropriate literacy curriculum and links to large numbers of local organizations. Motivate local organizations to provide ongoing support to groups and provide advanced training to the groups. Link groups into associations.</td>
<td><strong>Institutional Challenge:</strong> Create a cost-effective and large-scale credit delivery structure that covers its costs, accurately tracks loans and savings, prevents fraud, and that may eventually evolve into a regulated and even a commercial financial institution.</td>
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<td><strong>Definition of Sustainability:</strong> Large numbers of savings and credit groups operating independently; after two or three years with little to no ongoing support. Few groups have problems of fraud. Groups and NGOs spontaneously create new groups thereby expanding outreach. Retained interest income builds each group's loan fund.</td>
<td><strong>Definition of Sustainability:</strong> While startup costs and the initial loan capital are generally provided through grants, all operational and financial costs are eventually to be covered through the interest charged on loans. Evolution into a regulated financial institution ensures ongoing access to loan capital and accountability.</td>
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<tr>
<td><strong>Group Development Strategy:</strong> Base work largely on groups created for other purposes. Upgrade traditional savings and credit record-keeping systems rather than impose a standard model. Introduce village banking for interested groups.</td>
<td><strong>Group Development Strategy:</strong> Create new groups. Impose a single standard group template—generally some version of village banking or solidarity group lending—to insure standardization and control. Individual lending is increasingly prevalent.</td>
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<td><strong>NGO Strategy:</strong> Use large numbers of NGOs and other partners to provide access to existing groups and to provide simple support services to the groups.</td>
<td><strong>NGO Strategy:</strong> Either provide all services through program staff, or use one or two highly trained and supervised NGOs as mini MFIs to deliver credit services.</td>
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distribute, track, and collect, the possibility of fraud by the staff was greatly reduced. (There is, of course, a possibility of fraud within the groups, although there is little evidence of this occurring.) For their part, the groups were initially only asked to upgrade their traditional record-keeping systems, increase their savings, and improve their lending practices, rather than adopt formal village banking, which would have required much more training. The villagers found it easy to commit to WEP because they would not need to abandon the groups they were already members of. (Village banking—but without the "external" account—was introduced later in the program for those who were interested in meeting weekly and saving at a higher rate).

WEP served as the essential catalyst in this process. It provided the model, the curriculum and the more advanced training to the groups, secured the funding, and recruited, trained, and supervised the local partners. WEP stitched together the components of the program and then withdrew its staff and support to the local partners as its funding from AID ended. Since the groups could now keep their own books and could manage their own savings and lending activities, WEP had good reason to expect the groups it had trained, along with its partners, would continue to meet and grow. WEP's success, of course, must ultimately be judged in terms of the number of groups still saving, lending, and increasing their group funds in the years to come, a question that can only be answered by future evaluations.

The time limited catalyst and financial institution building models reflect substantially different approaches to microfinance. These differences can be seen most clearly in:
• The basic assumption about the need for external credit
• The institutional objectives
• The ancillary development objectives
• The challenges of institutional development
• The definition of sustainability
• The strategy for group development
• The strategy for working through NGOs.

These differences are summarized in Table 1.
Advantages and Disadvantages of the Two Models
Each model has its advantages. Under the WEP group-strengthening and savings-led model, it takes a group time and effort to build a substantial loan fund. The WEP model is also best suited to “horizontal” expansion: the creation of very large numbers of groups that provide simple services. The capacity for these groups to provide more services or to link these groups into associations that are more than opportunities to exchange experiences is limited, because their skills are only sufficient to manage funds at the group level.

In contrast, the MFI credit-led model requires an extraordinarily high level of organizational competence to reach substantial scale, since its basic objective is to transform an NGO into a bank with an NGO mission. While many NGOs can effectively train groups, few NGO have the capacity (or even the interest) to evolve into regulated financial institutions, or even a large-scale NGO. This explains why most credit led initiatives have a few hundred or a few thousand borrowers and why even fewer ever break even. In addition, the start-up costs per borrower to create an MFI is several times that of the savings-led model. The high costs help explain why most MFIs operate in urban areas or in densely populated rural areas. It is too expensive to push services out to rural areas and to serve clients whose needs for credit are very small.

Factors Contributing to WEP’s Success
WEP’s success does not occur in a vacuum, nor is it suggested that the WEP approach will work everywhere. WEP has been successful in the Terai of Nepal in part because it operates in an environment where there is a strong ROSCA tradition, known in the region as the Dhukuti. Dhukuti members contribute monthly to a collective fund. This requires regular meetings, the choice of a leader, accountability among members, the management of money, and the keeping of records, even if only on a scrap of paper or in the leader’s head. These are the same skills required for an economic group.
Additional contextual factors that encouraged the rapid growth of WEP include:

- The keen interest among the women in increasing their income and having a place where they can keep their savings out of the reach of family members
- Their interest in learning to read and write
- The high interest in women's empowerment and their desire to expand their role as decision makers in the household
- The modest rate of inflation
- The almost total lack of access to business financing for poor, illiterate women

The lively exchanges observed during the field visits where most members were eager to answer questions demonstrate how much these women had progressed. When asked how participating in WEP had changed their lives, the most common response was that when they started, they were shy and afraid to speak in a group but now felt they could speak freely. They also described how their husbands, who now see them as making a significant contribution to the family's income, hold them in greater esteem. When they joined the groups, even standing and stating their names was difficult for them.

**Reasons PACT Is Successful**

PACT developed its literacy and savings strategy based on its experience in literacy, not its knowledge of good microfinance practices. No mainstream MFI would have proposed delivering savings and credit services to 150,000 rural women all at once and then recruited 240 local partners to help them. For PACT, this was not as large a leap as it seems. PACT had previously worked with up to 1,000 local partners and hundreds of thousands of women through its literacy programs in Nepal. In PACT's eyes, microfinance was simply a matter of linking literacy to savings and credit, and adding microbusiness development and empowerment training as formal components. By avoiding the complex and problem-fraught issue of developing and managing a loan fund and taping into existing community
groups and local organizations, WEP was able to achieve impressive outreach quickly. The greatest advantage of the savings-led approach is its potential to reach impressive scale quickly at low cost.

The Potential Market
None of this would have been possible, of course, if there had not been a large market for the services WEP offered. In the initial months before it was clear how large the demand would be, WEP’s 240 NGO and MFI partners quickly identified 347,000 women who were ready to join WEP groups, but this number had to be scaled back to fit the budget. The partners’ enticement was the $39 monthly fee over 18 months for each 10 groups recruited, trained, and supported.1 PACT estimates that there may be an additional one million potential group members in the Terai and many more throughout Nepal.

The Benefits Are Obvious to the Clients
Another reason WEP found such an enthusiastic response is that WEP’s program spoke to these women’s priorities. They wanted to learn how to read and write, to have a place to save and to meet with a supportive group of women, and to develop businesses that would provide them with a source of income over which they had some control. WEP also operated largely through existing groups, which made the decision to join the project simpler than joining a newly formed group. WEP started by helping them upgrade the economic groups they were already a part of, rather than insisting they immediately adopt village banking with its requirement of weekly meetings and more savings. Village banking was introduced later, but only to those who were interested in the model and could meet the minimum savings requirements.

Local Partners Were Involved at an Appropriate Level
WEP worked successfully through so many local partners because the partners’ role was restricted to recruiting, support, and basic training—tasks that almost any local organization

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could carry out with minimal training. Using local organizations greatly reduced costs when compared to the higher staff costs of the PACT’s WEP staff and tapped into the partner’s extensive local contacts. This enabled the more costly and better-educated WEP staff to focus their efforts on training the local partners and providing higher-level training to the groups, especially in bookkeeping, thereby substantially reducing costs.

**Linkages between the Groups Were Encouraged**

Another feature of WEP was that connections between groups were encouraged through mobile workshops: monthly meetings where two leaders of ten groups meet for a day for training and shared experiences. The WEP staff ran these meetings, which focused heavily on record keeping. Exchange visits between groups also served to enhance connections between groups. In the final months of the project, WEP made a major effort to create associations of groups. In most programs, the key relationship is with the loan officer, not the other groups.

**Costs**

PACT received a grant of nearly $5.2 million from USAID Nepal to implement WEP over four years, or $42 per participant. This included all costs, even the charges for external technical assistance and headquarters support that are often left out of microfinance sustainability calculations. Roughly one third of the grant (32%) covered overhead and management support from PACT’s U.S. headquarters; 24% went to the salaries and benefits of PACT’s Nepal staff, including the project’s expatriate Chief of Party; 16% went to the in-country operations; 15% paid for staff training and literacy material development and production; and 13% reimbursed the NGOs that provided 840 Empowerment Workers (EWs) during the early phases of the project. Only $5.20 of the $42 cost per member, then, was used to pay the WEP partners for their assistance demonstrating the cost-effectiveness of working through local institutions.
When only WEP’s operating costs in the field are considered, the cost per participant decreases substantially to $18.42. Consider only the field related costs:

- **Phase 1**: 18 months (Dec. 1998–June 2000), $1,491,410 or $.64 per group member per month ($242 per group of twenty). This included staffing and support costs for 111 WEP employees in 8 district and three regional offices that served groups in 21 districts. In addition, 840 Empowerment Workers (EWs) were employed through PACT’s local partners. Each EW, outfitted with a bicycle for transport purposes, provided training in group study materials that reinforced literacy skills to 10 WEP groups. The EWs made regular biweekly follow-up visits to the participating groups. Local partners were paid $39 per month for every 10 groups they supported, which covered the costs of the empowerment workers and the support costs of the local partner.

- **Phase 2**: 15 months (July 2000–Aug. 2001), $905,000 or $.46 per group member per month ($138 per group of 20). In June 2000, the intensive field-based training was transitioned into a village bank (VB) strategy, continuing basic support to the remaining groups. In this second, more streamlined phase, 55 VB promoters were employed to assist the PACT trainers, and the district offices were rolled into the regional offices. Payment to the local partners was also decreased to $12 monthly for each 10 groups and most of the empowerment workers were let go. (Despite the reduction in funding, the partners visited 70% of their groups at least once during the previous month, according to the survey.)

- **Phase 3**: $250,000 annually or $.16 per group member per month ($77 per group over 24 months). This phase assumes that WEP secures additional funding and operates as a Nepali NGO. Since no additional funding has been received, this budget is only illustrative. $250,000 annually would cover a headquarters team of 7, 15 district level WEP
trainers, a minimal stipend for the local partners, and 150 WEP promoters recruited from the strongest of the group leaders. This level of funding would be sufficient to provide ongoing training to the groups through "mobile workshops," help strengthen the emerging associations, support the ongoing training and monitoring by the partners, and track the performance of the groups.

WEP's scaling down from $.64 to $.46 and eventually down to a projected $.16 monthly cost per member implies participants are quickly being transitioned from dependency on external technical assistance to independence. WEP's initial task of providing for women the necessary tools and skills to manage their groups required substantial up-front investment. In the WEP model all these training costs are subsidized.

According to these calculations, it would cost $457 to work with a group over nearly five years or about $23 per member. A $23 investment, then, would involve a poor woman in a well managed savings and credit group, build her assets, help her start an income generating activity, increase her decision making role and status in the household, teach her the rudiments of reading and writing, and help her become a community activist. The startup costs of an MFI would cost many times this amount per borrower and it is unlikely that an MFI would reach the same rural population that WEP did.

The Impact of the WEP Program on Groups and Individuals

The Group Study

The enthusiasm and commitment of the members interviewed by the research team prior to the formal evaluation was consistent and impressive, but were the groups visited truly representative of the program? Would these informal observations stand up if groups were selected randomly and consistently questioned on their performance? The study would provide answers to these questions. The important findings for each
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cluster of questions from the 200 groups selected for the study follow.

- *Is there a demand for the literacy and group development services that WEP offers?* WEP’s 240 NGO and MFI partners recruited 347,000 women for the project in under four months, reflecting the high level of demand for the services WEP was to offer. Financial constraints later caused that number to be scaled back to 130,000 women, organized into some 6,500 groups.

- *Since WEP was winding down its field presence at the time the interviews were being completed, were groups disbanding?* Only 2% of the groups had disbanded in the six months before the survey for programmatic reasons ranging from disagreements among group members, overdue loan payments, and uncollected savings.

- *Have the existing groups helped to create new groups?* Between 13% and 14% of the existing groups had created at least one new group without WEP payment or support. Most new groups were trained in villages that were less than 15 minutes from the group that provided the training, showing how localized this process of spontaneous replication was. In addition, the local NGO, cooperative, and MFI partners have created many new groups outside their contract with PACT. Reflecting the quality of the training they received, virtually every group interviewed could identify at least one member capable of providing training to other groups, and the average trained group had been visited by delegations from four nearby villages that requested their help in helping them organize their group. A strategy based on using trained leaders to expand could exponentially increase the number of groups served at very little cost.

- *What was the rate of group turnover?* Eight percent of the members of an average group had left over the previous six months. Despite the turnover, the size of an average group increased by one member since joining WEP. There is no shortage of women who want to join, with the average group considering, on average, seven potential new members.
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- Were poorer members being replaced by high caste and generally better off Brahmins and Chetris? The changes in the percentage breakdown of the caste affiliations of existing versus new members were minimal. There was little evidence, then, of "upward drift" in the groups.

- How good are these groups as savings institutions? The average group increased the amount of its group fund by 66% between April 2000 and May 2001, considering savings, retained interest earnings, fundraising events, fines, and book fees. The group fund is projected to increase another 56% over the next year. The savings rate increased from $.20 per member per month in June 1999 to $.45 a month in July 2001. The average group now has $300 in their loan fund, and all the groups taken together now have $1,900,000 in assets.

- Were these groups able to grant loans and get them repaid? Ninety-seven percent of the group fund was lent out and most of the money was lent in the same meeting in which it was returned as savings or loan payments. The groups generally charged a 2% per month flat interest rate on their loans to members and retained interest earnings were an increasingly important source for building the group's loan fund. Loan payment was acceptable: while 14% of the groups reported one or more late payments for their current loans, only 4% of the groups made a loan that eventually defaulted. Seventy percent of the members had taken out at least one loan. At the time of the study in May 2001, WEP, with its 45,000 borrowers, was the world's second largest village bank (VB) program, after Compartamos in Mexico. In May 2001 Compartamos, which began operations in 1992, had 49,000 borrowers and approximately 2,500 groups while WEP, which had started only three years earlier, had 130,000 savers and 45,000 borrowers and had worked through more than 6,000 groups. This illustrates how quickly savings-led programs can grow.
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- Are the loan funds sufficient to meet the demand for credit? Seventy-two percent of the groups say they need more money to meet the demand for loans ($52 per member on average). The remaining 28% claim they have sufficient savings to cover their credit needs. Since there was no assumption that an external loan would be provided, most groups were developing their own plans for increasing loan funds by increasing the savings rate, adding members, and carrying out more group income-generating activities.

- Do groups follow recommended practices of management? While most groups only accept payments at meetings (essential to maintain the transparency of the transactions) and close their books at the end of each session (essential for accurate records), only a minority of groups have elected new officers and deposit their excess funds in a bank. Attendance at meetings averaged 82%.

- Can groups keep their own records and is the quality of the records adequate? Eighty-two percent of the groups keep their own records and if they can't, depend most often on an educated relative, usually a member's husband, to keep the books if no one in the group has sufficient literacy skills. Only 1% depend on the WEP staff to keep the records and 4% on the NGO staff, a strong sign that groups are no longer dependent on institutions for record keeping support. When the researchers examined the records of the sampled groups, they determined that 85% had "average," "above average," or "superior" records, while the remainder had deficient record keeping. Those with "average" records find it difficult to calculate dividends and to track variable voluntary savings, although they can accurately track savings and loans. Those with above average or superior records can carry out these more complex calculations with ease.

- Have groups participated in WEP's efforts to create a network of groups so they are linked with each other instead of the staff? Over 80% of the groups participated in "mobile workshops,"

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where leaders of 10 groups came together to be trained and to share experiences. In addition, 60% of the groups participated in exchange visits between groups and 71% joined with another group for a campaign or project. Roughly a quarter of the groups belonging to WEP associations could assume an important role to go forward now that WEP has withdrawn its field staff. Ninety percent of the groups said they are getting stronger principally (according to them) because they have increased their savings and lending activities and because of the increased support and understanding between members and their families. The groups seemed little concerned that the WEP staff was leaving.

- Considering everything, how do the group members describe how participating in WEP has changed their lives? In listing the ways that WEP had changed their lives, the three most frequently mentioned categories had to do with empowerment and education, not savings and lending. Increased self-confidence and a greater role in decision-making were mentioned by the largest number of groups, followed by literacy and the knowledge of women’s rights. Savings ranked fourth, with a quarter of the groups mentioning it, followed by easy access to credit, and business development. Empowerment is evident in the activist stance women are taking in the community, including campaigns for preventing girl trafficking, abuse, and alcoholism, in addition to many community improvement efforts. The groups carried out more than 100,000 projects and campaigns since the start of the program, with the ratio of campaigns to projects increasing, reflecting the growing empowerment of the women.

Impact of Participation on Group Members
The results of the individual study reflected WEP’s wide-ranging impact. Unlike traditional microfinance programs, in which all resources are focused on making loans and getting them repaid, WEP has a much broader mandate. In addition to strengthening its groups as savings and credit institutions,
participating in WEP led to substantial increases in literacy and empowerment as the women learned to manage their groups themselves, instead of depending on an outside agency.

**Members of the WEP Groups**

WEP was asked to target rural women in the Terai, not poor women. Nevertheless, members of the groups assisted by WEP range from the poor who struggle to grow and earn enough to eat all year, to those who, within the context of rural Nepal, live comfortably. By working with a broad range of participants whose only common bond was their gender, WEP effectively enlisted the better off and better educated in the service of the poor. WEP gave educated women, often high caste Brahmins and Chetris (or lower caste women who were educated), the opportunity to use their education to teach others. By taking on their leadership and teaching/coaching role, these women gained respect in their communities. Better off and higher caste women are as subjugated by their husbands and the norms of Nepali society as their poorer and lower caste sisters. The differences between the poor, the emerging poor, and the better off groups were striking.

The poor made up 45% of the members of the WEP groups, i.e., about 55,000 of the 123,000 women currently served by the program. The poor often rented their homes or lived with relatives, and their per capita income was less than $75 annually. They were much more likely to speak a language other than Nepali as their first language and to belong to an indigenous or mixed caste group. Sixty-three percent of the poor had never been to school and only 13% had as much as eight years of schooling.

The poor were often almost or completely landless. A quarter restricted the number of meals they ate for part of the year and, when they could not meet their needs for food, worked as agricultural laborers, left the area to find work, or sold their meager possessions. In comparison, only 1% of the better off said they had to restrict the meals they ate last year,
and most of these could turn to friends and relatives to borrow at no cost the food they needed. A third of the poor said their household diet improved last year and 14% said that it had worsened, compared to the almost 60% of the better off who said their diet had improved, with none saying that it had worsened.

Three additional factors reflected the difficult circumstances of the poorest women: they were more likely to be widows (4% compared to 1% among the better off), to be heads of household (22% compared to 9%), and to have only one economically active adult per child. In the better off households the ratio is 1.6 economically active adults per child. This put a heavier burden on poor adults to provide for their children, and forced children into working roles earlier in life.

The households of the poor had on average less than 5 of the list of 20 household items (the better off have 14), of which only 1 was a high value item. (High value items included gold jewelry, a water buffalo, cow, sofa set, clothes closet, refrigerator, television, motorcycle, car, or pickup truck.) There are only 2 items owned by 70% or more of the poor: a bed and a stool.

That the poor were struggling to meet their most basic needs is reflected in the answer to this question: “How did you use the income from your business?” The poor answered food, clothing, and school expenses; the better off mentioned school expenses, saving, investing in the business, and buying items for the household. While the poor were surviving, the better off were investing in the future.

The emerging poor constituted 35% of WEP group members, i.e., about 43,000. The households of the emerging poor owned, on average, 10 items on the list of 20 (compared to 5 for the poor), and of these, 2.4 were on the high value list. The emerging poor generally owned their homes and had enough land to produce what they need to eat for the year (three-quarters of the group were food self-sufficient, compared to only half of the poor).
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The per capita income of the emerging poor may reach $160 per year, considerably less than the Nepali average of $210 per year, but still double that of the poor; 41% of the emerging poor had never been to school, while a third had as much as eight years of schooling.

The better off make up approximately 25,000, or the top fifth, of the group members. The households of the better off owned on average 13.3 items on the list of 20 household items, and of these, 4.5 were high value items. The better off owned their own homes, which were often located in regional cities and larger towns. Eighty-six percent say they have enough land to produce all they need; virtually all speak Nepali and more than 80% are high caste Brahmins and Chetris. Per capita income was often above the $210 average for the country. The better off were, not surprisingly, the best educated group, with only 17% having never having gone to school, and close to 60% with eight years or more of education.

Changes in the Lives of the Members
The process of change documented through the individual questionnaires can be attributed to the frequent literacy meetings, the training received from the WEP and local partner staff, and the investments the participants made in their businesses. The groups held a monthly saving and borrowing meeting (a weekly meeting for the VBs) and met additionally for literacy classes and Rights and Responsibilities training provided by the Asia Foundation from three to seven days a week during the first 18 months of their participation in WEP.

One of the most important findings of this investigation was that the impact of participating in a WEP group cuts across income categories. Impact was measured in six areas, with important changes registered in each:
- Changes in the women's sphere of influence in the household
- Literacy
- Mutual assistance
- Savings and borrowing
- Business development
- Income and well-being
Women's Role in Decision-Making Expanded Considerably

The process of change started with increasing one's sphere of influence, the areas where the individual feels she can make changes. Through WEP, women could become leaders and express their concerns at group meetings. The savings and loan funds administered by the group were often the first resources these women managed on their own. The fact that the WEP groups combine savings and lending with literacy and meet several times a week to learn to read and write or to help others learn these skills strengthens the women's belief that they can make further changes. This belief was further reinforced by the fact that on every page, the WEP curriculum made the assumption that participants will start businesses, run groups, and take an activist role in the community, creating an ethos that favors progressive change.

The women were asked if their decisionmaking had increased in four key areas. While it would be expected that these changes would be greatest for the best educated and the better off, a strikingly large percentage of the poor and uneducated reported they had more authority in the household.

<table>
<thead>
<tr>
<th>Decision making areas increased in these areas</th>
<th>8 Years of schooling or more</th>
<th>No schooling</th>
<th>Better off</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family planning</td>
<td>75%</td>
<td>59%</td>
<td>74%</td>
<td>62%</td>
</tr>
<tr>
<td>Children's marriage</td>
<td>72%</td>
<td>64%</td>
<td>82%</td>
<td>62%</td>
</tr>
<tr>
<td>Buying and selling property</td>
<td>82%</td>
<td>76%</td>
<td>86%</td>
<td>72%</td>
</tr>
<tr>
<td>Sending daughter to school</td>
<td>89%</td>
<td>82%</td>
<td>87%</td>
<td>81%</td>
</tr>
<tr>
<td>Decision-making increase in other areas</td>
<td>75%</td>
<td>63%</td>
<td>81%</td>
<td>65%</td>
</tr>
</tbody>
</table>
Literacy

WEP starts with literacy. Considering the short time the program has been operating and that volunteers run classes at night—often by kerosene lantern after the women have put in a long day of arduous work—the increase in literacy rates was striking. Of those who had no formal schooling at all, half can now read a paragraph “easily” or with “some difficulty,” a quarter more can read a paragraph with “great difficulty,” and only a quarter cannot read at all. Almost 63,700 women learned to read at some level through their participation in WEP. The rest were already literate or never learned to read.

Mutual Assistance between Members

A large proportion of women helped each other with their businesses. Although there was no baseline data and the level of mutual assistance could not be ascribed strictly to participation in WEP, this fact is nonetheless impressive. The Table 3 lists the most common types of business assistance women reported receiving and the percentage of women who received it.

Group Members Became Active Savers and Borrowers

While virtually all the women in WEP were savers and many were borrowers, the amount saved and borrowed, the difficulty in repaying loans, and the use of the loans and additional sources of saving and credit services varied greatly. The poor, compared to the better off,

- Saved half as much on average as the better off—$15 compared to $31
- Were half as likely to save voluntarily, reflecting the fact that the better off are more likely to belong to village banks, where the rate of voluntary savings is much higher
- Were as likely to have taken out four or more loans; but the amount they borrowed was half as much as that of the better off members
- Were twice as likely to have had problems repaying their loans, reflecting their precarious economic condition; the primary reason for difficulty in repaying the loan was sickness in the family
Table 3. Types of Mutual Association

<table>
<thead>
<tr>
<th>Activity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Got advice on how to produce</td>
<td>40%</td>
</tr>
<tr>
<td>Got advice on selling</td>
<td>36%</td>
</tr>
<tr>
<td>Accompanied me to the market</td>
<td>35%</td>
</tr>
<tr>
<td>Shared tools and equipment</td>
<td>32%</td>
</tr>
<tr>
<td>Produced together</td>
<td>23%</td>
</tr>
<tr>
<td>Sold my goods at the market</td>
<td>19%</td>
</tr>
<tr>
<td>Sold another member's goods</td>
<td>17%</td>
</tr>
<tr>
<td>Shared transportation</td>
<td>13%</td>
</tr>
<tr>
<td>Made a loan payment for me</td>
<td>12%</td>
</tr>
</tbody>
</table>

The poor were also twice as likely to have used their loan for nonbusiness purposes, although the percentage who had diverted their loans was reportedly small (12% for the poor, 6% for the better off).

For most women, the WEP groups were the only place they saved, and for even more, the only place where they borrowed. There are a few exceptions: about a fifth of the better off saved with another group, an NGO, or a bank; and 16% of the poor currently have a loan from a money lender, reflecting the lack of alternatives.

Increases in Business

Ninety percent of participants said they were involved in an income generating activity now, compared to a third before they joined WEP. This substantial change can be attributed, at least in part, to the literacy curriculum that described women starting and running a business. Other factors included the support of the group, the training they had received from the WEP and NGO staff, and access to loans. Reflecting the nature of this highly rural economy and the fact that the household is seen as the economic unit in Nepali culture, most were making a business out of what they had always done: raising animals, growing vegetables, and other agricultural activities. Three-quarters also saw these as household, not individual,
Table 4. Business Activity

<table>
<thead>
<tr>
<th>Income generating activity before WEP</th>
<th>8+ years of school</th>
<th>No school</th>
<th>Better off</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Sales increased” after WEP</td>
<td>32%</td>
<td>37%</td>
<td>36%</td>
<td>25%</td>
</tr>
<tr>
<td>“Sales the same” after WEP</td>
<td>63%</td>
<td>41%</td>
<td>59%</td>
<td>42%</td>
</tr>
<tr>
<td>“Sales decreased” after WEP</td>
<td>24%</td>
<td>38%</td>
<td>22%</td>
<td>36%</td>
</tr>
<tr>
<td>Type of business that earned most money in the previous year</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commerce</td>
<td>26%</td>
<td>18%</td>
<td>25%</td>
<td>22%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3%</td>
<td>3%</td>
<td>7%</td>
<td>4%</td>
</tr>
<tr>
<td>Service</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
<td>5%</td>
</tr>
<tr>
<td>Agriculture or livestock</td>
<td>67%</td>
<td>75%</td>
<td>64%</td>
<td>70%</td>
</tr>
<tr>
<td>Is business:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primarily your own</td>
<td>34%</td>
<td>23%</td>
<td>32%</td>
<td>21%</td>
</tr>
<tr>
<td>Primarily household enterprise</td>
<td>65%</td>
<td>75%</td>
<td>67%</td>
<td>77%</td>
</tr>
<tr>
<td>Spent time working at business last month</td>
<td>93%</td>
<td>92%</td>
<td>96%</td>
<td>92%</td>
</tr>
<tr>
<td>Keep records in ledger now</td>
<td>48%</td>
<td>23%</td>
<td>43%</td>
<td>18%</td>
</tr>
<tr>
<td>Kept record in ledger before WEP</td>
<td>25%</td>
<td>15%</td>
<td>25%</td>
<td>9%</td>
</tr>
</tbody>
</table>

There were substantial differences in the progress made by the businesses across economic and educational categories. Three factors could have contributed to this difference: the better off and better educated were more likely to be involved in commerce, service, and manufacturing, and they were twice as likely to record their costs and sales; they also borrowed twice as much.
Differences in Income Growth

The most dramatic difference between the poor and the better off could be seen in individual earnings from the previous year: the better off and better educated pulled far ahead of the poor. One obvious reason for a difference in income between the two groups was that the better off found jobs while the businesses of the poor often had declining sales and illness in their families. What is more significant is that most reported having an independent source of income. Before WEP, only a third said they had any type of income-generating activity.

Recommendations

As with any undertaking breaking new ground, WEP could have spent its resources more wisely had it been clear from the start that its objective was to provide some measure of ongoing support to the groups. The group leaders and key NGO staff would have been trained accordingly to take on this role. While the data collected in this evaluation indicates that most groups will likely keep operating now that WEP has withdrawn its field staff, a recommendation for future programs would be to invest in a more modest, but longer, technical support plan.

A second issue was that in the project’s final year, most of the staff’s effort went into training what were to become 1,500 village banks (VBs), which were drawn from the strongest savings and credit groups. Consequently, while the VBs’ performance greatly exceeded that of the other groups, some of the remaining economic groups that did not receive this intensive support may falter. More balanced assistance between VBs and economic groups may have resulted in greater impact overall and fewer of the weaker groups disbanding.

Implications of the WEP Model

The greatest challenge facing the microfinance field is that of reaching substantial numbers of the rural poor. To achieve such numbers, the costs per person assisted need to be kept in
check. Over the past two decades, the strongest players in the microfinance field have moved in the direction of ever larger, more centrally controlled, and more sophisticated institutions. Many are becoming regulated banks that specialize in reaching microbusiness owners, while some commercial banks are also starting to access this market as it becomes clearer that there is money to be made. There is no question that this has been a stunning achievement for a field that is little more than 20 years old. Every country has a number of microfinance programs, perhaps one or two good ones and many more that are struggling.

WEP is also reaching a substantial scale, and at a cost that is only a small fraction of the cost per member of what it would cost to start an MFI. It is also much easier to reach scale using this model. WEP was working with 6,500 groups with 130,000 members within sixty days of beginning operations. Just counting the number of WEP's current borrowers already puts WEP in the top tier of outreach among village banking programs worldwide.

The key for the savings-led model, then, is decentralization and local control. The task of the intermediary is to act as the short-term catalyst to build basic skills, and later to nudge along an ongoing process. A point should be reached where such a catalyst is no longer needed, and the trained participants can manage whatever evolves. It may someday be shown that the best path to reaching scale, in even the most difficult settings, may be to develop local capacity and then to get out of the way. This underscores the need for providing good training.

Considering the vast number of self-help groups in villages across the developing world, a strategy that can transform these groups into well-managed, local savings and credit institutions with literate members who are building equity has great appeal. By sidestepping the entire problem-fraught issue of creating a permanent and sustainable financial institution, many practitioners may choose this model, based on teaching
and facilitating, over financial institution building. Building autonomous groups may also prove to be a preferable strategy for reaching large numbers of the rural poor in the poorest countries where financial institutions are weak and illiteracy high. The potential demand for these services could easily range in the scores of millions worldwide. WEP estimates that the demand for its services could reach one million in Nepal alone.

Notes

The complete version of this report including questionnaires and detailed data analysis can be obtained from JAAshe@aol.com

1. The fee was reduced to $12 monthly for an additional 15 months once the literacy materials had been distributed and the women had begun to learn to read and knew how to manage their groups.

2. Cost data was taken from WEP monthly reports as of April 2001, prior to complete spending of the grant in September 2001.

3. The fact that so many of the partners are still visiting the groups bodes well for the partners continuing to serve the groups now that WEP's funding has ended. This should not be surprising: the partners were working with most of these groups before they joined WEP and these organizations often have multiple sources of funding. Moreover, working with these now much stronger groups will make it easier to secure more funding.

4. Since no donor has come forward, PACT is using its own resources to cover the costs of providing ongoing assistance to the groups in two of the 21 districts where WEP previously had an active presence.

5. If all costs are considered including overhead and materials development, all external technical assistance, publishing and distribution, it would have cost $87 per group member monthly over the 46-month life of the program ($52,000/130,000 members/46 months).

6. The value of current loans overstates the amount of the group fund loaned out since at least some loan payments come in monthly (the rest are repaid in a lump sum at the end of the loan period).
Community Savings Funds

Providing Access to Basic Financial Services in Marginalized Rural Areas of Mexico

by Gabriela Zapata

Abstract: The Community Savings Funds (CSFs) promoted by the Ministry of Agriculture in Mexico seek to provide marginalized community groups with a simple mechanism that allows them to save and administer their own funds securely, efficiently, and profitably, according to their own needs and priorities. Specially trained promoters help set up CSFs for a period of one year—using a standardized Toolkit—after which they are expected to work autonomously. There are 540 CSFs in 12 states with over 12,800 members and savings totaling 4.45 million pesos (US $445,000). This paper describes the characteristics of the CSF model and the results to date. It discusses implementation problems and issues of sustainability and growth in light of the new regulatory environment. It also debates the viability and desirability of autonomous savings and credit groups at the community level and the advantages and disadvantages of their inclusion into the formal financial sector.

Introduction

In 1997, the then Ministry of Agriculture, Livestock, and Rural Development in Mexico launched the Rural Development in Marginal Areas Program, which sought to improve the well-being and income of smallholders living in communities of less than 2,500 inhabitants in 24 of the most marginalized rural
areas in the country. Over the next five years, the program provided funds for rural investment projects to farmers’ groups under a matching-grants scheme and other support services (research, extension, information, and training) to over 350,000 farmers in 15 states.

The program promoted an investment-recovery mechanism at the end of the productive cycle to gradually reduce farmers’ dependency on grants and foster better accountability and resource generation at the community level. Under this scheme, participating farmers’ groups were expected to “recover” a previously agreed percentage of the returns from their investment in order to set up a revolving fund. Extension workers assigned to work with farmers’ groups were in charge of verifying that groups were indeed “recovering” a percentage of their returns. The incentive system was built on the concept of community responsibility and participation, including peer pressure. If a particular farmers’ group failed to set aside a portion of the returns, the members of the group could receive no further grants. The idea was that recovered funds keep revolving at the community level according to internal priorities and decision-making mechanisms.

However, no methodology was provided to set up these revolving funds, so farmers’ groups either spent or reinvested surplus funds at will, or opened a group bank account where such facilities were available (with negligible interest rates)—either leaving the funds idle or using them as their counterpart contribution for next year’s grant.

This situation forced the Ministry to look for a standardized methodology that could be used by community groups to set up the revolving funds. In mid-2000, the Ministry received World Bank funding to hire specialized consultants for a period of six months to design and launch the project. During this time, a proper methodology and action plan were

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developed to set up Community Savings Funds (CSF) among participating farmers' groups. The objective of these CSFs was to provide marginalized community groups with a simple mechanism that would allow them to save and administer their own funds securely, efficiently, and profitably. The concept of "recovery" was dropped and the idea of "savings" was promoted instead. Specially trained CSF promoters began to work with community groups, emphasizing that (a) participation in a CSF was completely voluntary; (b) the money saved by each individual belonged exclusively to that individual; and (c) CSFs were autonomous—with all decision-making in the hands of group members themselves. CSFs were funded through members' savings, remittances, or wages, since the program provided no external seed capital for their setup. It did provide the training to operate CSFs by a promoter and an "Administrative Toolkit," consisting of simple but adequate record-keeping tools and easy-reference manuals.

There are approximately 420 CSFs formed through the Marginal Areas Program in 12 states, with over 11,500 members and savings totaling some 4,090,000 Mexican pesos (US $409,000). Each CSF has a one-time setup and follow-up cost of about 10,842 pesos (US $1,084) or 310 pesos (US $31) per member during the first year. These figures are approximations based on information available in the Project Coordination Unit, monthly reports sent to this office by participating states, and a number of field visits. Since no thorough evaluation of the project has been conducted to date, the data reported here are not conclusive. An additional 120 CSFs have been set up by a nongovernmental organization in the State of Guerrero, which requested training in for its credit officers in the CSF methodology earlier this year. Sixty of those CSFs are reported to be fully operational, with 1,384 women and savings of over 360,000 pesos (US $36,000).

Showing that savings led microfinance is not only an Asian and African phenomena, the Mexican Government has underwritten the training of 420 Community Savings Funds with
over 11,600 members since mid 2000 and has plans to expand this number to 2,000 with more than 80,000 members over the next several years. Each CSF mobilizes its own savings manages its own loan fund, similar to the other self-help group initiatives. Considering that only 4% of the eight million economically active population in the rural areas of the country have access to financial services from banks, nonbank financial institutions, or government agencies, the potential to develop this market niche is great. (There is likely to be a similar demand for these services in other poor Latin American Countries.) The cost for training a group averages $31 per group member and includes the fee to the promoter, transportation and a model kit that presents all the systems needed to manage a group. Given current legislation, project coordinators are developing a strategy to link these groups to the formal financial sector while ensuring that the needs for the poor continue to be met.

In the course of this year, the Ministry has had to rethink its CSF consolidation and expansion strategy, owing to the lessons learned from experience as well as the passing of the new Savings and Credit Law by Congress in 2001. The law seeks to regulate all nonbank financial operations involving savings mobilization over the next two years. While no clear guidelines are given in the law for groups such as the CSFs, it is expected that they will gradually be incorporated into the legal system. Admittedly, there will be some drawbacks to the formalization of CSFs, such as obtaining lower returns on their savings, which are currently high due to the monthly nominal interest rates of 5–15% charged on credits. However, formalization would allow CSFs to guarantee the security of their members’ savings and benefit from services such as remittance reception, insurance provision, and lines of credit, to which they would otherwise not have access.

This paper explains the main characteristics of the CSF model—including the Administrative Toolkit—and the services CSFs provide. It also discusses issues of sustainability, and the
risks and challenges of growth, and it explains the Ministry’s new strategy for ensuring the provision of savings-based sustainable and secure financial services in marginalized rural areas in the context of the new regulatory environment. Through these topics, the author hopes to contribute to the debate on the viability and desirability of autonomous savings and credit groups at the community level and the advantages and disadvantages of their link-up to the formal financial sector.

Characteristics of the CSF Model

The backbone of the CSF methodology is members’ trust in each other and their own savings. Other basic characteristics include the promotion of group organization and solidarity; fostering of a responsible savings and credit culture; flexibility and adaptability to local needs and conditions; ownership and administration by members themselves; and absolute proximity to the clients.

The fact that the CSF Project does not focus exclusively on providing credit for productive activities is another characteristic that sets it apart from most government microfinance programs. People in marginalized rural areas have many consumption needs at different times of the year which often do not coincide with the times when returns from productive activities are available. In response to this need, the vast majority of CSFs have decided to grant credit for consumption requirements. This has proven very attractive to members—so much so that many members choose to take credit to meet consumption needs rather than withdraw from their savings.

All aspects pertaining to the operation of the CSF, such as interest rates, type of savings and amounts, loan types, loan terms, subscription fees, meeting times, and the like, are decided by all members—according to their needs and priorities—and incorporated into the Internal Rules & Regulations of each CSF.
Table 1. Record-Keeping Tools of the Administrative Toolkit

<table>
<thead>
<tr>
<th>Type</th>
<th>Tool</th>
<th>Priority of Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normative</td>
<td>CSF Incorporation Agreement</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Internal Rules and Regulations</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Minutes Book</td>
<td>Required</td>
</tr>
<tr>
<td>Control by member</td>
<td>Beneficiary Designation Letter</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Member Savings and Credit Passbook</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Savings and Credit Duplicate Ledger Cards</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Attendance List</td>
<td>Required</td>
</tr>
<tr>
<td>Record-Keeping</td>
<td>Daybook</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Credit Control Book</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>Income and Expenditure Control Book</td>
<td>Required</td>
</tr>
<tr>
<td>Complementary</td>
<td>Individual Member Cards</td>
<td>Recommended</td>
</tr>
<tr>
<td></td>
<td>Membership Certificate</td>
<td>Optional</td>
</tr>
<tr>
<td></td>
<td>IOU</td>
<td>Recommended</td>
</tr>
<tr>
<td></td>
<td>Cash Book</td>
<td>Recommended</td>
</tr>
</tbody>
</table>

In general, promoters encourage CSF members to evaluate results at the end of the year, during which time they analyze the costs and benefits of belonging to a CSF based on overall safety of their savings; amount of dividends gained; accessibility to savings or credit; opportunity conflict resolution relating to the operation and administration of the CSF; benefits from the training and follow-up of the promoter; adequacy of meeting
times; and ease of use of the Toolkit. Successful groups rank high in all of the above, while unsuccessful ones fail at one or several aspects.

The Administrative Toolkit

The Administrative Toolkit is a standardized, yet flexible, kit used by every CSF for adequate record-keeping. It was developed by the author and two colleagues, with World Bank support, based on materials previously tested and used in the field by the author, as well as on feedback from local microfinance practitioners. The Toolkit consists of 14 tools (see Table 1), ten of which are considered indispensable for appropriate record-keeping, guaranteeing transparency, and accountability.

The kit also contains a calculator, ink pad, stamps, and two manuals. One of the manuals explains the use of each tool and the methods to distribute dividends at the end of a cycle. This manual is accompanied by an educational video that explains all the tools, with graphic examples. The other manual explains the general objectives and nature of CSFs, the guidelines for the promotion of CSFs, and the design of Internal Rules & Regulations. Prior to their publication, all of the materials were tested in various communities where the majority of the population had very basic reading and writing skills. To date, no requests to change any of the materials have been made.

The Methodology: Promotion, Constitution, and Consolidation of CSFs

Local Ministry of Agriculture offices in every state were responsible for the promotion, constitution, and consolidation of CSFs. Each office was asked to select an adequate number of promoters to be trained in the CSF methodology and service all the farmers' groups that had participated in the Marginal Areas Program. The methodology follows four basic steps:

- *Training of CSF Promoters.* This consists of an intensive training session for CSF promoters, lasting 2-3 days, provided by the Ministry's Project Coordination Unit. The
training focuses on the strategy for setting up CSFs, the use of the Administrative Toolkit and manuals, the design of Internal Rules & Regulations, the gradual transfer of knowledge to group members, and CSF supervision. The training session is designed for selected CSF promoters who should have knowledge of math, basic accounting or finance, community work and, preferably, some experience in microfinance.

- **Identification of potential groups.** Promoters identify groups that have the desire and potential to set up a CSF, meaning they have at least two members who can read, write, and do basic math, are trusted by other group members, and agree to serve as treasurer and secretary of the CSF; have the capacity and willingness to save and work as a group; and preferably have between 15 and 25 people who are willing to meet as often as the group determines and to abide by its Rules & Regulations. In order to generate interest in the formation of CSFs, promoters show a one-hour video about two community groups that form CSFs (one all-male, one all-female), the problems they face, and how they fare. A question and answer session follows the show.

- **Constitution of a CSF Management Committee.** Once the groups have been identified, the next step is the selection of management committee members to manage the CSF with the help of the promoters. Committee members are elected by group members, unless only two group members can read, write, and keep basic accounts, in which case, they are elected by default. The roles of each member are described in the manuals, although additional functions may be added at member request. In general, groups have and need only a treasurer and a secretary, who are in charge of handling the money and record-keeping. Larger groups tend to have a president and a credit committee as well. Once the management committee has been elected, founding members of the CSF write up an Incorporation Agreement, which is signed and stamped by a local authority, giving the CSF more
formality. The promoters then proceed to schedule the training sessions with the group.

- **Training of the Group Members and Follow-up.** Once the CSF is constituted, promoters conduct a series of training sessions for the members, with special emphasis on management committee members. During these training sessions, group members begin to learn how to design the Rules & Regulations—adapted to their needs and conditions—as well as to use all the tools in the Administrative Toolkit. This process lasts about 10–12 months, during which promoters meet regularly with group members, playing more of a supervisory role as the group itself learns how to operate all the tools. Promoters do not impose decisions; rather, they are equipped with options and examples that allow them to help the group make decisions that are conducive to CSF sustainability. Once the CSF is proficient in the use of all the tools, it is ready to operate autonomously. Under the new CSF strategy (to be discussed below), CSFs can request follow-up or specific training from promoters beyond the initial 10–12 month period.

**Services Offered by CSFs**

The main service a CSF provides is, as its name indicates, savings collection. CSF members generally set a minimum amount of systematic savings that must be deposited by each member either weekly or fortnightly. Members themselves determine both the amount and the frequency of deposits. Members are often fined if they do not comply with this rule, but are usually allowed to save beyond the minimum. Although the calculation of returns on savings at the end of a cycle is made easier by the collection of equal, systematic deposits from all members, practically every CSF has chosen to offer flexible deposit and withdrawal services. Most groups calculate and divide their earnings annually. Under a flexible deposit-and-withdrawal scheme, the procedure for calculating earnings is somewhat complicated. However, committee members can
receive specialized training and supervision from promoters at this point and can also refer to the manual and video for a detailed explanation of the procedure.

Groups generally begin by saving for 2-4 months to allow themselves to amass a large enough sum to lend out or invest in a productive project. They also do this to see who is or is not a systematic saver, believing that someone who is able to save is more likely to be able to repay a loan. The need for credit is so strong, however, that many CSFs soon begin to lend to one or two people whatever savings they have collected. Once they repay, they lend out the money to other members—Tanda- or ROSCA-style—until there is enough to go around for everyone who needs a loan. The number of borrowers vs. the number of savers varies by CSF and depends on the number of members, amounts saved, and credit needs.

Loan terms range from 1 to 6 months, using various repayment schemes. The four payment methods are fortnightly payments of capital and interest in equal amounts; 12 monthly payment of interest and payment of capital at the end of the term; deduction of interest at the beginning and payment of capital at the end of the term; and payment of capital and interest at the end of the term in one lump sum. This last method is only generally allowed for credits of 1-2 months.

Some CSFs have also started to provide check-cashing services for their members and others. This is a costly undertaking for individuals, particularly since transportation costs can amount to 10-20% of the value of the check. For this service, everyone pays a very small fee to cover the costs of transportation of the person going to town, while the remaining amount is used to capitalize the CSF. Of course, there is a risk that this person may be robbed with all the cash in hand, but the lower cost of this service seems to outweigh the risks involved.
Table 2. Number of CSFs, Members, and Savings by State (July, 2002)

<table>
<thead>
<tr>
<th>State</th>
<th>No. of CSFs</th>
<th>No. of members</th>
<th>Amount of savings (Mexican Pesos)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chiapas</td>
<td>218</td>
<td>4,858</td>
<td>$786,951</td>
</tr>
<tr>
<td>Chihuahua</td>
<td>3</td>
<td>130</td>
<td>$220,500</td>
</tr>
<tr>
<td>Guanajuato</td>
<td>34</td>
<td>334</td>
<td>$48,729</td>
</tr>
<tr>
<td>Guerrero</td>
<td>9</td>
<td>399</td>
<td>$206,425</td>
</tr>
<tr>
<td>Hidalgo</td>
<td>20</td>
<td>466</td>
<td>$275,860</td>
</tr>
<tr>
<td>Michoacán</td>
<td>23</td>
<td>480</td>
<td>$103,248</td>
</tr>
<tr>
<td>Morelos</td>
<td>5</td>
<td>64</td>
<td>$22,405</td>
</tr>
<tr>
<td>Nayarit</td>
<td>6</td>
<td>88</td>
<td>$7,804</td>
</tr>
<tr>
<td>Oaxaca</td>
<td>53</td>
<td>2,267</td>
<td>$1,839,327</td>
</tr>
<tr>
<td>San Luis Potosí</td>
<td>14</td>
<td>1,246</td>
<td>$437,445</td>
</tr>
<tr>
<td>Tabasco</td>
<td>14</td>
<td>562</td>
<td>$47,500</td>
</tr>
<tr>
<td>Veracruz</td>
<td>21</td>
<td>759</td>
<td>$120,710</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>420</strong></td>
<td><strong>11,653</strong></td>
<td><strong>$4,094,499</strong></td>
</tr>
</tbody>
</table>

Rules to Date

The approximately 420 CSFs reported to exist in 12 states (see Table 2) have over 11,500 members, with savings totaling some 4,090,000 pesos (US $409,000). As Table 3 shows, CSF savings increased by 254% between 2000 and 2001 and by July 2002, they had increased a further 130%. Sixty-two percent of the members are men and 38% are women, half of whom are indigenous peoples. Thirty-five CSFs are all-female, 22 are mixed, and the rest are all-male. In the mixed groups, few of the officers are women. Male domination is compounded by the low literacy rates in women in marginalized rural areas and the lack of Spanish skills in indigenous communities. Thus, women tend to occupy a leadership role only in all-women groups.

On average, CSFs have 35 members and their one-time set-up and follow-up cost amounts to approximately 10,842 pesos.
Table 3. Amount of and Increase in CSF Savings (2000-2002)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSF Savings</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexican pesos</td>
<td>$1,244,867</td>
<td>$3,158,700</td>
<td>$4,094,499</td>
</tr>
<tr>
<td>% Increase</td>
<td></td>
<td>254%</td>
<td>130%</td>
</tr>
</tbody>
</table>

*by July 2002

(US $1,084) per CSF or 310 pesos (US $31) per member during the first year. It is interesting to note that only 15% of current CSF members participated in the initial Marginal Areas Program, meaning that CSFs have spontaneously incorporated other members of the community.

The average savings rate of CSFs is difficult to establish at this point, since variations among groups are great. Reportedly, CSFs lend out 25-100% of their savings, depending on group members' need for credit; the size of the group and amount of savings collected; their level of competency at using the Toolkit; and the amount of money needed as their counterpart contribution to receive grants from government programs, among others. Interest rates are set by the members and range between 5% and 15% monthly, based on village level market rates, which are much higher. The recovery rate on loans has been practically 100% and no frauds have been reported.

CSFs are divided into four levels, according to their degree of development (see Table 4). Level 1 includes groups that have collected funds from various sources—with or without having formally constituted a CSF through an Incorporation Agreement—and have not yet started systematic savings collection. Information provided by the various states indicates that between 2001 and 2002, there was a considerable drop in Level 1 CSFs from 73 to 11. This was due to the fact that many of those funds had been formed under pressure by promoters...
Community Savings Funds

Table 4. Existing CSFs by State and Level of Development (July 2002)

<table>
<thead>
<tr>
<th>STATES</th>
<th>No. of CSFs</th>
<th>LEVELS</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Chiapas</td>
<td>218</td>
<td>178</td>
<td>40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chihuahua</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guanajuato</td>
<td>34</td>
<td>34</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guerrero</td>
<td>9</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hidalgo</td>
<td>20</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michoacán</td>
<td>23</td>
<td>23</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morelos</td>
<td>5</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nayarit</td>
<td>6</td>
<td>6</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Oaxaca</td>
<td>53</td>
<td>46</td>
<td>7</td>
<td></td>
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<tr>
<td>San Luis Potosí</td>
<td>14</td>
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<td></td>
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<tr>
<td>Tabasco</td>
<td>14</td>
<td>10</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Veracruz</td>
<td>21</td>
<td>5</td>
<td>15</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>420</td>
<td>11</td>
<td>221</td>
<td>179</td>
<td>10</td>
</tr>
<tr>
<td>%</td>
<td>100</td>
<td>2.6</td>
<td>52.6</td>
<td>42.6</td>
<td>2.3</td>
</tr>
</tbody>
</table>

or lacked sufficient follow-up to be able to make the transition to Level 2. Many of these funds were in the state of Chiapas. This state has made several unsustained attempts to promote the CSF strategy. Its latest effort includes the incorporation of 10 new promoters and a series of intensive workshops. Previous efforts, however, have been mostly obliterated by changes in government leadership and lack of funds to pay promoters, so it remains to be seen whether this latest effort will actually take root.

Level 2 includes formally constituted CSFs that have started systematic savings collection, are learning to use the Toolkit, and are in the process of designing Internal Rules & Regulations. Two hundred and twenty one—the largest number of CSFs—are in this level. Whether they manage to make it
to Level 3 will depend on the availability of competent promoters to give them the required training.

Level 3 includes 179 CSFs that are using the Toolkit and have started to offer credit services with the collected savings, according to their Internal Rules & Regulations. Due to the high turnover among promoters, many of the CSFs that might today have been in Level 3 either closed down or stopped receiving follow-up, and therefore are not reported in Table 4.

Finally, Level 4 includes 10 CSFs that have microregional or regional outreach. However, since no external evaluation of the CSF project has been conducted to date, it is impossible to establish with any precision the level of autonomy reached by CSFs at this point.

Thirty-nine promoters were trained during the first year to promote CSFs in marginalized rural communities.6 In theory, they should have been able to set up around 320 CSFs—or 8–10 CSFs each—during that time. However, project implementation was negatively affected by a very high level of turnover among promoters. In anticipation of this problem, the Project Coordination Unit had designed and distributed a job description to participating states to ensure the adequate selection of CSF promoters. Nonetheless, the vast majority of hired promoters did not fit the profile—many of them were agricultural extension agents or veterinarians—while those who did could not always count on a paycheck at the end of the month, since many local ministry offices had not provisioned enough resources to pay their salaries and travel expenses. To date, only two CSF promoters remain of the first 39 who were trained. Another group of 26 promoters was trained during the second year, of whom only 14 remain.

This problem owes largely to the incorporation of the CSF strategy, which was perceived an afterthought rather than an essential component of the Marginal Areas Program. Moreover, microfinance was not high on anyone’s-agenda at that point. Consequently, the selection of appropriate CSF promoters and the provisioning of resources to pay them
received little or no importance. This resulted in increased costs of CSF promotion and hampered the continuity of already-established funds.

In January 2002, a new approach to create CSFs was tried. The approach involved training 20 credit officers of an existing women’s organization—the Unión de Organizaciones Económicas y Mujeres Productoras de Guerrero—that knew about the methodology and was interested in trying it out with 80 of its best “solidarity groups.” These groups had been initially formed to receive credit from the Microfinance Fund for Rural Women—a fund that extends lines of credit to intermediary organizations to be channeled to solidarity women’s groups for productive activities. Some of the groups had started saving small amounts of money but had no methodology to administer it properly, hence the request for training in the CSF methodology.

Since then, the Unión has formed 120 CSFs, 60 of which are in Level 2 and 60 in Level 3, the latter with 1,384 women and savings of over 360,000 pesos (US $36,000). In general, savings range between 300 and 1,000 pesos per member. These CSFs tend to lend 80% of their accumulated savings—at a 5% monthly interest rate to members and 7% to nonmembers—while keeping some 20% for emergencies. The recovery rate is reported to be 100%. Recently, the Unión had 80 more Toolkits reproduced of its own accord for use with other solidarity groups who are demanding a methodology to administer their savings. This leads us to believe that the option of working through established organizations is desirable and can greatly help expand the outreach of the CSFs in a reliable and controlled fashion.

**Profit and Sustainability**

CSFs are expected to be financially immediately sustainable, since they receive no seed capital or external financial support other than the training, follow-up, and Toolkit. Promoters can determine the level of financial sustainability of a CSF through
the use of a simple Financial Simulation Model designed by the Project Coordination Unit.

The model is designed in Excel and includes a few fixed variables and a number of other variables that can be adapted to fit the characteristics of a particular CSF, such as number of members, volume of savings, liquidity levels, interest rate, operational costs, and delinquency level, among others. This helps promoters identify potential or actual trouble spots that may affect CSF sustainability, and determine its level of profitability, the percentage of savings used for credit, and so on. By detecting problems in a timely manner, promoters can suggest changes that will improve CSF performance. The model, while useful, has some limitations, because it is not flexible enough to incorporate the various modes of credit rotation that CSFs use. Nonetheless, it gives a general picture of a CSF's cashflow behavior.

Although individual weekly or fortnightly savings are usually quite low (US $1-$5), CSFs tend to capitalize fairly quickly, thanks to the high interest rates charged on credits. Moreover, many CSFs use the credit repayment scheme that consists of systematic and equal payments of capital at a flat interest rate, causing the real interest rate to be higher. While this makes the loan more expensive for the client, it generates more money for on-lending to more people and allows the CSF to pay better returns to savers at the end of the cycle. Level 3-4 CSFs—for which information is available—have generated an average annual net profit of 6.32% per CSF.

Most CSFs collect a membership fee from every member. With this fee, CSFs form a contingency fund. Members themselves decide on payment terms and conditions (such as a one-time fee, a payment in installments, or an annual fee). This contingency fund is either lent as credit—when the need for money is high and savings are insufficient to meet it; kept in a bank account or safe box; used as a matching-grant contribution to invest in a joint productive project; or used to finance a joint community project. Many CSF groups have decided to
distributed only 80% of their annual net profit among themselves, designating the remaining 20% to capitalize the contingency fund.

Fines are another source of revenues for CSFs. These are charged—depending on the group—for nonattendance or late arrival to meetings; not complying with the minimum mandatory savings requirement; or not paying a loan on time. In addition, some municipal presidents have “awarded” CSFs a grant to reward their savings efforts.

CSFs operational costs are either nonexistent or very low, including such expenses as photocopies, transportation to the nearest bank, and so forth. Eventually, CSFs would be expected to replace or reproduce the materials in the Toolkit and perhaps even pay for the services of a promoter directly.

**Overcoming Risks and Challenges of Growth**

Keeping the cash safe is risky in a marginalized rural setting. Given that reliable financial intermediaries are generally not available in these areas, CSFs’ surplus income is handled in the following ways: lent out to nonmembers; \(^{17}\) kept in a safe deposit box with 2-3 different locks, for which an equal number of members have one key; deposited in a bank account whenever a member happens to go to the nearest town (taking care to never follow a pattern so as to not be identified and possibly robbed); or kept by the treasurer in case someone has a need for an emergency loan.

There are obvious risks involved in all these methods; but most consider it riskier to keep their money under the mattress. Mostly, however, rather than keeping the funds, these are lent out to members for various activities, including investment and consumption. Emphasis is placed on diversifying risk by lending to people who are involved in different productive activities or who have various ways of paying the loan if it is taken for consumption purposes (such as through remittances or wages).
So far, the recovery rate on loans has been practically 100%. However, as groups become larger and liquidity increases, the level of risk also rises. Manual record-keeping becomes more time-consuming and complicated, both for management committee members and for members themselves. In addition, larger volumes of cash begin to be handled, which implies greater risk and requires more attention to detail and strict controls, particularly because the foundation of trust—in a context where everyone knows each other—begins to weaken as the group grows. Some of the solutions that CSFs have discussed or implemented include purchasing a computer and training the treasurer and secretary in its use; introducing assistants to help the treasurer and secretary with the transactions; breaking up a large CSF into smaller units that are linked to each other, forming a microregional CSF; creating “solidarity groups” to expedite credit approval; or linking up with a formal financial institution.

Nonetheless, this issue continues to present many challenges, both for the CSFs themselves and the institutions that promote them, especially in light of the new Popular Credit & Savings Law.

**Regulatory Environment: Popular Savings and Credit**

The Popular Savings & Credit Law, passed in 2001, seeks to regulate the activities and operations of nonbank financial institutions that mobilize savings in order to promote their healthy development; protect the interests of members and clients; and foster the provision of reliable savings and credit services. These institutions will have to be financially, administratively, and organizationally viable to be certified by the National Banking Commission.

The law divides organizations into four levels, according to their degree of institutional development. Level 1 incorporates the smallest financial intermediaries, which must have at least
100,000 UDIN in capital, at least 200 members, and adequate reserves, among other requirements.

One drawback of the law is that it makes no provisions for small credit and savings groups which do not meet the minimum requirements but which might otherwise work well. It thus leaves the formation of new financial intermediaries in a gray, unregulated area, until they can develop enough to be able to meet the minimum requirements of the law. However, a reform initiative is in the making, which would allow for these groups to exist legally as long as they have less capital and fewer members than those required by Level 1 intermediaries. Under this initiative, small groups will not be allowed to advertise their services publicly, and will have to register with a federation of their choice and make known to their members that they are neither regulated nor authorized by the National Banking Commission.

While this initiative leaves a space for CSFs to operate autonomously, it effectively puts the Ministry’s CSF project in the spotlight. Being a government-sponsored project—with a database accessible to other government offices—it cannot sidestep the law, designed by another arm of government that regulates the sector by promoting hundreds of autonomous CSFs over which no one has any real control. This means that CSFs will have to comply with the rules established by the new reform initiative if it is approved by Congress.

**The Change of Strategy: Forging a New Path to Provide Savings Services to the Rural Poor**

As a result of the problems faced in the implementation process of CSFs as well as the new legal environment, the Ministry of Agriculture has had to rethink its CSF consolidation and expansion strategy. The new strategy envisages two main changes: the training and certification of specialized CSF promoters and the promotion of CSF networks in marginalized rural areas.
Training and certification of specialized CSF promoters. A specific and thorough training program is being designed jointly by the Ministry's Project Coordination Unit and the National Training Institute for the Agricultural Sector. The program will include topics, such as introduction to rural microfinance; use of the Toolkit; design of CSF's Internal Rules & Regulations; risk management; financial self-sufficiency; the Popular Savings & Credit Law; and cooperative principles, among others. The objective of this training program will be to certify those applicants who meet program requirements and include them in the Ministry's register of approved service providers.

Inclusion in this register would allow CSF promoters to be eligible to be "hired" directly by community groups for the provision of training and technical assistance to constitute new CSFs or train previously existing groups in specific aspects of CSF development. Funding for community groups to hire certified promoters is available from the Ministry's Capacity Building Program (PRODESCA) under a matching grants scheme. In order to access these funds, community groups will have to present a project proposal with the help of the promoter. The proposal must include a task-specific work plan and calendar, which will then be submitted to the State Technical Unit for approval. Under this scheme, community members decide which promoter to hire, rather than accept the one assigned to their village by the government. Promoters are thus encouraged to advertise their services in communities that have the interest and potential to set up a new CSF or improve an existing one. Promoters will receive payment from the program once they have delivered previously agreed-upon products and the state Technical Unit has established that the community group is fully satisfied with the service provided. Thus the scheme ensures that certified promoters are not only able to find employment but also deliver a quality product in a finite period of time.
Promotion of CSF networks in marginalized rural areas: The second component of the new strategy seeks to promote CSFs as part of a wider strategy to both develop formal financial service networks in marginalized rural areas and increase outreach more effectively. Rather than promoting hundreds of CSFs in remote villages—whose follow-up by individual promoters would be very difficult—the new strategy envisages the creation of CSFs networks by linking new or existing CSFs to each other to form a formal financial intermediary in its own right, particularly in areas where no such services exist; working through already established farmer organizations with an interest in providing financial services to their members (as in the case of the Unión), subsequently constituting themselves as a formal financial intermediary if they are willing and able to do so; identifying existing formal financial intermediaries that are interested in incorporating CSFs as clients or members; or becoming a branch or service desk for an existing formal financial intermediary.

Although autonomous CSFs might be a desirable option for faraway and scattered village groups, in order to increase the breadth and depth of outreach in rural areas in a meaningful way, we believe it is more efficient and effective to provide services through a network rather than to hundreds of individual groups. Not only would one need an army of promoters to train the groups and do follow-up, but keeping track of their performance by a government office would prove impossible. In the long run, we believe that more benefits can be accrued by CSF members if they are part of a network than if they are alone.

As CSFs networks formalize, individual CSFs will undoubtedly sacrifice the comparatively larger amounts of revenues they currently earn on their savings. However, the trade-off will be that they will gain access to secure savings mechanisms and a variety of other services which they would otherwise never be able to afford, such as remittance reception, insurances, access to ATMs, and so forth. Once formally
constituted, they will also be able to negotiate lines of credit with various providers.

This is still a long way off, but government programs cannot afford to look at the short term any longer—strategies must be designed with the long term in mind. Successful cooperative bank networks that have gradually managed to provide services in rural areas have been established in many countries; there is no reason why Mexico should not learn from their experience and build a similar future for itself.

**Rural Microfinance Technical Assistance Project (PATMIR)**

The formation of networks and the provision of formal financial services in rural areas according to the law is no easy task. To this end, the Ministry of Agriculture launched another related project in the year 2000, namely the Rural Microfinance Technical Assistance Project (PATMIR). PATMIR's main objective is to expand the provision of formal financial services in marginalized rural areas that are sustainable, self-managed and adapted to local conditions, with an emphasis on savings. This is achieved by improving the financial stability and outreach capacity of existing savings and credit institutions and creating new ones where none exist, enabling them to link up to local, regional, or national networks and federations, according to the law.

PATMIR's work focuses on selected marginalized rural areas which lack financial services but which have enough population density to allow for the development of financially sustainable services. Specialized consultant firms are in charge of spearheading the process of designing and implementing a regional strategy, whose purpose is to narrow the gap between supply and demand of financial services in rural areas by providing training and technical assistance to both existing financial intermediaries (supply side) and their potential clients and members at the grassroots level (demand side).

This regional scheme promotes the organization of grassroots groups, such as the CSFs, with the purpose of linking
Community Savings Funds

them to networks that allow them to become part of a wider financial services system that belongs to the poor and satisfies their specific needs. This project thus presents another alternative for certified CSF promoters to be hired—in this case, by the specialized consultants—to form CSFs at the village level within the regional strategy.

Conclusions

Although no formal evaluation of the process of creation and follow-up of CSFs has been conducted to date, several insights and useful lessons can be drawn from the experience.

The CSF project has shown that there is a need and interest in marginalized rural areas to have financial services that are accessible, reliable (as compared to available options), profitable, and adapted to people’s needs. The potential for expansion of financial services in marginalized rural areas is great, considering that only 4% of the 8 million economically active population in rural areas have access to financial services. Promoting CSFs through existing organizations that can guarantee the provision of follow-up services by promoters seems to be a strategy worth pursuing, judging by the example of the Unión.

CSFs were launched as an option for the very poor to operate their own financial mechanism based on their own savings and following their own rules with the help of a Toolkit and the necessary training to use it. While CSFs often constitute a better option than others available in marginalized rural areas, their breadth of outreach is ultimately limited. Given the simplicity of the record-keeping tools, expansion of a CSF can be limited by several factors, such as level of literacy or education, lack of access to a computer, and so forth. Moreover, the poor in rural areas not only need, but also deserve, the same quality of service offered by other financial intermediaries in wealthier, more populated areas. This includes a guarantee that their savings will be kept safe no matter what; thus the need to find ways to link them to the formal sector.

Although CSFs provide savings and credit services only to their members and their failure is unlikely to pose any threats to macroeconomic stability, the recent failure of other
nonbank financial intermediaries (due to mismanagement, fraud, and so forth) has sown fear and distrust in this type of institution—which was ultimately unable to guarantee the safety of members' savings—thus negatively affecting the image of the nonbank financial sector. Therefore, the challenge faced by the projects supported by the Ministry of Agriculture is to provide a service that is sustainable and able to offer guarantees, as well as a variety of products and services that people in marginalized rural areas require to improve their standard of living.

In light of the new Popular Savings & Credit Law, the pursuit of a strategy that promotes the unregulated proliferation of autonomous CSFs would be shortsighted. However useful these funds might be to marginalized communities in the short-term, we believe that their orderly development, as part of a strategy to weave formal networks from the bottom up, will result in a more robust financial service system of and for the poor in the longterm—a novel approach that is well worth a try.

Notes

3. The Marginal Areas Program's matching-grant scheme required farmers to make a counterpart contribution of 30%, obtaining the other 70% required to finance the productive project from the program itself.
4. The consultants included the author of this paper.
5. This cost includes the training of CSF promoters ($342 pesos per CSF), monthly salaries of CSF promoters ($7,000 pesos per month), travel allowances of promoters ($1,000 pesos per month), educational materials used to work with the groups ($200 pesos per CSF), and one Administrative Toolkit ($700 pesos per Toolkit). It assumes that each promoter assists 10 CSFs during a particular year.
6. The CSF Project Coordination Unit is under the Office of Promotion of Financial Organizations (Dirección de Fomento de Organizaciones Financieras), Department of Rural Development, SAGARPA, Mexico City.
8. See endnote 5.
9. In many rural areas, interest rates charged by informal money lenders can be as low as 20% per month and as high as 20% per day.
10. An additional 400+ extension agents were trained in the CSF methodology during that time. Given their regular contact with community groups, the training was done with the idea that they could help identify interested groups and provide general support to CSFs. While several of them have done this—and a few have even set up CSFs out of their own initiative—they have no direct contact with the Project Coordination Unit, and thus no detailed information is available on such CSFs.

11. Fondo de Microfinanciamiento a Mujeres Rurales—FOMMUR, currently under the Ministry of Economics.

12. It is complicated for CSF members to calculate interest on a declining balance basis. Despite the fact that systematic payments of capital at a flat interest rate cause the real interest rate to be much higher, people find this method much simpler to calculate.

13. Although they are encouraged not to do this, many CSFs still do it, specifically to people from the community who are known to be good payers but who are not interested in becoming members of the CSF (either because they are wealthier, do not have the time to attend the meetings, etc.). These individuals are normally asked for collateral and are charged a higher interest rate than CSF members by 2–4 percentage points, which is still lower than the informal money lenders' rates.

14. These are groups of 3–7 members which get together to discuss and approve/disapprove each other’s credit applications. If one of them is not requesting a credit, he or she may also become a guarantor of another who is. The group then presents all the approved applications to the committee members for their processing.

15. UDIS = Unidades de Inversión, or investment units—an inflation-indexed currency unit, currently equivalent to 3 pesos (30¢) per unit.

16. Instituto Nacional de Capacitación para el Sector Agropecuario, locally known as the INCA Rural.

17. Programa de Desarrollo de Capacidades en el Medio Rural (PRODESCA).

18. Proyecto de Asistencia Técnica al Microfinanciamiento Rural (PAT-MIR).

19. The Project is currently being implemented in the state of Chiapas and the Huasteca Region (incorporating parts of the States of Hidalgo, San Luis Potosí, and Veracruz). In 2002, the Project will include the states of Guerrero and Morelos as well as the rest of the State of Veracruz. In 2003, the Project will expand to the states of Oaxaca, Michoacán, Estado de México, Puebla, and Tlaxcala.
CARE's Mata Masu Dubara (Women on the Move) Program in Niger

Successful Financial Intermediation in the Rural Sahel

by William J. Grant
Henry C. Allen

Abstract: CARE’s Mata Masu Dubara (MMD) project is a women’s time-bound accumulating savings and credit association (ASCA) program in rural Niger. Over the past decade, CARE has facilitated the creation of over 5,500 active women’s groups with over 162,000, providing the purest forms of financial intermediation to their members in some of the poorest parts of Niger. Working from a very simple and appropriately adapted savings based product, sustainability and replication of the associations is easy to achieve. Due to the overwhelming demand for the product, CARE’s role has evolved from service provider creating the associations to a facilitator that trains local animators who are then paid by the village women to train them. CARE estimates that there is a minimum of 200,000 practicing members with over $3 million in savings. This article examines the nature of markets for rural financial services in the Sahel and the characteristics of the MMD model that respond so well to that market. It also reviews the limitations of the model, and some of the adaptations that CARE has introduced to successfully replicate the program in numerous other countries in Africa.
Introduction: Setting the Scene

For decades, governments and donor agencies have been trying to establish viable financial systems to meet the productive needs of the populations in the rural areas across Africa. For a variety of reasons, few institutions have succeeded in sustainably delivering financial services to this target market. This is particularly true in the poorer and less densely populated countries of the Sahel in West Africa, especially in the rural areas where there is less economic activity.

In the face of this poor track record for creating viable financial services, one program has had phenomenal success. Over the past decade, CARE Niger has developed and implemented the Mata Masu Dubara (MMD) program, a self-managed system of the purest form of financial intermediation. Based on own savings and self-management, CARE’s MMD is now a membership based program directly servicing about 162,000 rural women in one of the poorest countries in Africa. MMD is not a single institution, but rather is an amalgamation of 5,500 stand-alone groups, each with about 29 members. In addition, due to hands off replication methodologies sponsored by CARE, CARE estimates that for every village in which it has taught the MMD method, there is at least one additional group that has formed on its own. This brings the total number of women practising the approach to about 200,000. Total savings are estimated at $3 million. While each MMD group has its own bylaws, sets its own interest rate, and keeps the life of the group fixed, nearly all of the MMD groups operate in identical ways. Though independent, the women in MMD groups across the country identify with the methodology and consider themselves “MMD.”

This article will review the origins of MMD, the reasons the program has been successful, its limitations, and the benefits

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Volume 4 Number 2
to the members. CARE has replicated MMD in other countries, whose performance will also be reviewed.

Some Theoretical Background

Understanding why MMD has succeeded where so many others have failed starts with an understanding of financial services in rural markets in Africa. This includes the relationship between the cost structure of the institution relative to the carrying capacity of the clients, as well as the appropriateness of the financial services to the needs of the people. MMD, as will be shown, has developed a product for its clients that fits client needs because it allows the clients to be the managers and designers of the products and services. In addition, the institutional structure is light and affordable to the clients.

While the focus of most governments and donors has been on productive credit, this population needs a range of services. These include savings as well as credit, both for consumption and social purposes, as well as economic activities. MMD starts with savings since, from the perspective of the poor, savings are usually more important than credit. Credit increases risk while savings reduces it. Since the poor are risk averse, they have greater demand for savings services than for credit.

The demand for savings services is apparent across West and East Africa, but the challenge is to make those services profitable. While savings and credit unions in West Africa have many members and the SHDF in Zimbabwe has had 250,000 members, sustainability has proved illusive. Meanwhile, credit granting institutions, while seeking to cover their costs, often provide too much credit to the poor which increases their vulnerability. Since interest charged on the loans pays for operating costs, liquidity is drained out of the rural areas. MMD has managed to find the right mix of savings and credit services that allows the poor to save while making productive use of these resources in the community.

Delivering sustainable financial services in rural areas depends on developing an organization that meets the needs of the market and generates enough income to cover costs. Some
of the factors that lead to increased costs of providing rural finance in remote rural areas include:

- Isolation and poor road and communications infrastructure
- Low productive capacity that reduces the profitability of business investments
- Smaller loan sizes and high fixed costs, which are often exacerbated by distance
- Seasonality of cash flow that requires larger cash reserves and lump sum repayments that also increase the risk of bad debt
- The risk of poor harvests that can affect the entire client base in a region
- More barter transactions that can make collection more difficult

Government involvement in the sector has led to a number of problems. Repayment histories have been problematic, based largely on the poor track records established by large government rural credit schemes that have forgiven the loans in years of poor production, ingraining bad repayment habits. Traditions of interest rate ceilings and subsidized interest rates have kept profits low and have not provided incentives to financial institutions to voluntarily enter the market.

A review of rural financial institutions (Grant & Ndour, unpublished) carried out during 1999 and 2000, which classified market areas or client groups by their market potential, identified the type of structure of a financial institution that could be viable in that geographic market. Broadly, these indicators were: (a) the productive capacity of the region; (b) the seasonal nature of activities; (c) the level of monetization in the area and market access; and (d) social and organizational strength in the community. Five broadly different types of markets were identified (see Table 1).

The few successful microfinance services in West Africa operate in urban areas (which also have higher population densities) or in rural areas with developed infrastructure, such as cotton growing zones. But in the sparsely populated and
<table>
<thead>
<tr>
<th>Area</th>
<th>Type of Market</th>
<th>Productive Capacity</th>
<th>Seasonal Nature of Activities</th>
<th>Monetisation</th>
<th>Social and Organizational Strength</th>
<th>Economic Potential</th>
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<tbody>
<tr>
<td>1</td>
<td>Isolated rural semi arid</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
<td>Strong solidarity</td>
<td>Weak</td>
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<tr>
<td>2</td>
<td>Landlocked rural with food-producing potential</td>
<td>Medium</td>
<td>High</td>
<td>Medium</td>
<td>Strong solidarity</td>
<td>Weak/Medium</td>
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<tr>
<td>3</td>
<td>Rural accessible with cash crop production activities</td>
<td>Medium/High</td>
<td>Medium</td>
<td>Medium/High</td>
<td>Strong solidarity</td>
<td>Medium/High</td>
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<tr>
<td>4</td>
<td>Peri-urban area</td>
<td>High</td>
<td>Low</td>
<td>High</td>
<td>Impersonal</td>
<td>Medium/High</td>
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<tr>
<td>5</td>
<td>Urban areas</td>
<td>High</td>
<td>Low</td>
<td>High</td>
<td>Very impersonal</td>
<td>High</td>
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undeveloped rural areas, there have been few successes. In order to succeed in these markets, a financial service provider must have a very light cost structure to survive. This can usually be achieved only through a truly decentralized structure, in contrast with a devolved structure, where most decisions are still made centrally. The CARE sponsored MMD program in Niger stands out as a rare success story for successfully serving this market.

MMD/Niger History and Methodology

*Mata Masu Dubara* means “Women on the Move” in Haussa. In 1991, CARE International in Niger launched its first MMD project in the Department of Maradi. Started with the support of CARE Norway, the the project set the goal to help women cope with the numerous and increasing responsibilities they faced in an increasingly unfavourable socio-economic and religious environment. Initially, the project trained women in artisanal production and other small economic activities so that they could increase their household incomes. In addition, women contributed individual savings to a savings and credit fund which, in turn, made small loans to the members. The project quickly evolved towards helping women meet what they considered to be most important—organizing and operating their own savings and credit associations. MDD evolved into a financial sector project, rather than being designed to do so from the start.

The MMD methodology evolved over time, but has its roots in the time-bound accumulating savings and credit associations (ASCA) (Rutherford, 2000). It builds from a rotating savings and credit association (ROSCA) which is commonly used by women in Niger, but has added many different twists. Unlike ROSCAs, MMD borrowers must repay the loans with interest each month. ASCAs are formed for a specific cycle (time-bound), usually 9 to 12 months, set with a specific objective in mind. These objectives might include a religious holiday, the end of the cropping season when there is no money,
or the beginning of school: all events which require funds. Once the objective is achieved, the members divide up the portfolio equally among the membership (or a proportion thereof). The groups usually re-form immediately, with members having the right to leave the group if they wish and new members may be inducted.

The methodology evolved slowly. Initially the groups were loose, informal associations of women. Through internal evaluations, CARE realized the necessity for more formal structures. CARE instituted a training program that specified the roles and responsibilities of group officers and the general assembly and helped each group to develop its own set of internal regulations.

The project's approach to training and graduating groups also evolved steadily. Initially it took about 18 months of monitoring and training from the CARE team for a group to graduate. But after much discussion, the group development process was streamlined into three phases (once the groups were identified) that took only eight months and required significantly less input from the project staff. The three phases are an intensive start-up phase, a development phase, and a maturation phase.

- During the intensive phase, a CARE animator visits the group for its weekly meetings, training the group members in the basics of the organizational dynamics and monitoring their progress. The women learn the basic procedures of savings, credit, and payment of interest and fines. The learning process is active, as the members begin to take loans and pay interest. After the first six weeks of skill training, the agent continues to make weekly visits to help members perfect their understanding of the basic structure, but during this time the women progressively assume responsibility for the management of their own affairs.

- During the three-month development phase, the group becomes more self-reliant. The weekly contributions and loans continue, but the village agent visits every two weeks during the fourth month and only once a month in the fifth
and sixth months. The agent assumes the role of observer, allowing the women to lead the group themselves.

• In the maturation phase, the group works independently. The agent makes one visit in the last two months to conduct a final evaluation of the savings and credit activities and to discuss any problems. Otherwise, the women operate autonomously throughout the final stage.

The group is "graduated" after eight to nine months, if the final objective has been met—whether it is to divide the savings among the members, or use the savings for a group activity. The overwhelming majority of groups (95%+) continue their operations, often increasing the amount of their weekly contributions.

MMD based its activities on groups of up to 30 women meeting weekly, saving their money in fixed weekly contributions, and providing month-long interest bearing loans at every fourth meeting. The women select themselves, which allows them to reduce moral risk at the inception of the organization by not including women with poor reputations for financial and moral integrity. One of the selection criteria is usually that the women must be carrying out an income-generating activity that will allow them to make productive use of resources.

The women determine the amount of the weekly contribution. This has been set as low as 50 CFA per week (between $0.05 and $0.10 US) or as high as 500 CFA per week (between $0.50 and $1.00), according to the capacity of the women to pay. This is often related to the overall level of economic activity in the region. Each woman contributes the same amount, though some women make multiple contributions to the group, effectively buying several shares of the total activity. These contributions are fixed for the life of the group. As there are often several groups within the same village, women tend to segment themselves; women able to use larger sums of money joining one group, and women with lesser financial capacity joining another group.
While the women in the group are free to set their own interest rate, almost all of the groups in Niger have chosen a rate of 10% per month. Lending begins once sufficient funds have been accumulated, usually about eight weeks after inception. Loans are repaid every fourth meeting, and the capital along with the additional savings contributions that have been received over the three previous weeks are immediately loaned out again. Loans are made to a member on a basis of need and the group’s assessment of her ability to repay.

Initially the project experimented with using symbols as a substitute for formal written records, but rapidly abandoned this practice. CARE realized that in order for the groups to continue once the CARE agents were no longer working with them, it was important to have a system that the group itself could continue. Since many groups lacked literate or numerate members who were capable of maintaining record books, CARE developed a methodology that did not rely on written records. To this day a majority of MMD groups do not maintain written records. In fact, a 1994 evaluation discovered that members of groups with no written records had a better knowledge of the financial state of affairs of their groups than those groups that maintained books.

To cope with security concerns, CARE came up with the idea of a metal lockbox. Because the officers of MMD groups are often drawn from the prominent families in a village, only treasurers were empowered to hold the lockbox in safe keeping between meetings. Each lockbox was fitted with three padlocks and three members of the group’s management committee held the keys. This reduced the likelihood of theft, since collusion amongst the three would be highly unlikely. The lockboxes greatly increased the confidence of members regarding the safety and security of their savings.

Evolution of the Program
The MMD program developed slowly. However, because it was given time to learn by experience and by making small mistakes, it was able to stop any major problems. By the end
of 1993, it became clear that CARE Niger had the beginnings of a real success on its hands.

The project was initially managed by an expatriate advisor, who had no background in financial services. This might have been an asset in terms of developing a program that could respond to the needs of its members. Since the mid 1990's, the project has been entirely managed and staffed by Nigeriennes.

The program has been driven by the demand for services by the members. Once a critical mass of groups has been developed in a region, news of the efficacy of the methodology spreads and the demand for new groups becomes overwhelming. From 1996 onwards, MMD as a methodology was spread to other parts of the country by experienced and confident staff. The history of MMD's expansion is summarized in Table 2.

In the late 1990's, when the project staff could no longer meet the demand for training new groups, CARE developed a "village agent" system that could continue after the end of the project. In the village agent system, interested women provided an animator to CARE for training. CARE then started focusing on training the trainers, who were paid by the groups themselves. Women set aside small sums of about 50 CFA each per meeting in order to pay the animator. This meant a local animator could earn 1,500 CFA per meeting assisted, per group. Over the course of a month, an animator might support 10 groups, which can make for a very good income for a rural woman.

Table 2. Growth in Clients Number and Number of Groups

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<tbody>
<tr>
<td>Members</td>
<td>1,500</td>
<td>2,805</td>
<td>3,744</td>
<td>6,121</td>
<td>21,745</td>
<td>40,777</td>
<td>123,189</td>
<td>159,109</td>
<td>162,128</td>
</tr>
<tr>
<td>Groups</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Avg</td>
<td>45</td>
<td>90</td>
<td>92</td>
<td>176</td>
<td>647</td>
<td>1,266</td>
<td>3,179</td>
<td>5,557</td>
<td>5,546</td>
</tr>
<tr>
<td>Member/ Group</td>
<td>33</td>
<td>31</td>
<td>41</td>
<td>35</td>
<td>34</td>
<td>32</td>
<td>39</td>
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<td>29</td>
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</table>

* In addition, there are presently another 16,238 women being trained in 61 groups.
The program has seen amazing growth since late 1998 when it started training facilitators to carry out the work of the CARE staff, who have now become primarily supervisors and trainers of trainers. Over the past four years, approximately 500 facilitators have been trained. Facilitators work for a period of eight months under the guidance of a CARE trainer, and then continue working on their own to create new groups. While the project realizes the importance of capturing the increasing the number of MMD groups forming outside the direct supervision of CARE, finding the financial and human resources needed to do this continues to be a challenge for the project management. As a result, CARE only reports on groups they track directly. It is very likely that there are many more groups out there than CARE is aware of.

Benefits and Limitations of the Model

Why has MMD been so successful in rural Niger, where there are no other functioning formal financial systems? The very nature of the product makes it highly desirable to the participants. As will be shown below, it provides a very high return on savings allowing use of the funds at the same time. Moral hazard is kept to a minimum because the members are borrowing their own money, and they have strong incentives to stay with the association as a member in good standing until the predetermined end date at which point the distribution will take place.

Benefits

MMD provides important financial benefits to its members, creating a good incentive for them to participate actively and remain loyal to the program.

A. Participating in the MMD program yields a high return on investment/savings. Under a standard program, with a weekly payment and loans being made at 10% per month, an individual will earn over 50% return on the total savings deposited over a 10 month period. This yields an annual return
of 76% on deposits. When taking the average savings into consideration (as opposed to total savings), this return increases to up to 250% per annum. If the interest rate is set higher (as the group members have done in the CARE program in Zimbabwe) to compensate for a higher inflation environment, then the return can increase accordingly (see Figure 1). In Zimbabwe, with an annual inflation rate of 123%, the groups charge 20% per month and earn a net return after inflation of 15% per annum, which is roughly 65% higher than savings in commercial financial institutions.

**Figure 1. Return on Savings (from Zimbabwe)**

![Figure 1. Return on Savings](image)

B. The program allows the members to make productive use of financial resources. Unlike savings clubs, the funds do not sit idly in a savings account but are available to be used by members on a regular basis while they are building their savings. Unlike in a ROSCA, each member can get access to some credit at all times. Easy and regular access to the funds is a
major benefit. The majority of the loans are used for productive purposes.

Loan sizes are flexible and are fixed by members, allowing them to take the amount that they can use appropriately. While this factor is necessarily limited by the amount of funds in the group, during the later months of a savings cycle, this presents less of a problem. In fact, one frequently sees quite sizeable differentiation in loan amounts between the members.

Figure 2. Main Uses of Credits Taken by MMD Members

The members have the option of taking loans or not, depending on their financial needs of the moment.

C. Though the model is very simple, there have been many adaptations. With experience and sophistication, groups begin to offer variable shareholdings and variable loan terms and the option of balloon and equal installment payments. Some programs provide an administrative mechanism to allow people to borrow for longer terms, so long as they keep paying interest.

D. The fixed end date and the disbursement of the funds provide tangible incentives to the members. At the conclusion of the MMD cycle, when the funds are disbursed, the program provides households with a lump of financial resources to be used to meet the larger financial needs of the households. These include buying food (if the disbursement comes during
the lean season before the harvest), buying inventory or fixed assets (such as land or livestock), and meeting social responsibilities (such as dowries, weddings, or funerals). With a clear endpoint to the group, the members know that it is a finite program with a clear exit strategy and they can plan the use of their funds at that point in time.

E. There is no financial leakage from the individuals or the community. Because the members make all of the interest payments to themselves (since they compose the group), all proceeds stay in the community. This has the dual benefit of enriching the community, while also increasing the return to those who use the funds for their own economic purposes. It also makes it easier for an individual to repay, even when she is stretched to do so, as the money is really going back to herself.

At the community level, retaining the interest earnings in the community is one of the most important developmental benefits of the program. The 50% to 100% interest charged by most African MFIs is drained out of the community. Keeping the money in the community facilitates trade and increases the level of economic integration. The more goods and services
that are attracted to a rural market, the better the quality of rural life and the opportunities to be economically active.

F. Accruing funds through savings may start slowly but rapidly surpasses the amounts that would be available from donor loan funds. The rate of growth of the funds in the village groups increases dramatically as the size of the fund increases from regular contributions, higher interest payments, and penalties. A group with 25 members, each contributing $1 per week for 40 weeks, and making loans at 10% beginning after week 8, will amass $1,572 after 40 weeks, or $62.89 each. The same group, charging 20% per month will amass $2,510, or over $100 each (see Figure 4).

G. The exposure to loans and the rigors of repayment builds the financial management capacities of the borrowers/savers and enhances their understanding of and sophistication in how financial services work. This finding is not unique to MMD and has been seen in small village based programs—as women start handling loan funds, they learn the advantages and limitations. They learn how much they can effectively use and realize very quickly when they have borrowed too much. Interviews with numerous MMD members have demonstrated that they have learned their own financial
limits and those of their economic activities. This increases their overall financial sophistication.

MDD provides an interesting contrast to the traditional MFI, which provides the opportunity for enterprise growth because it intermediates between those who need capital and those who want to store it. But MFIs and loan officers are often removed from the reality of the economic investment opportunities and often aggressively push loans, in order to meet their growth targets, to individuals who might not need them. The MMD approach prevents over-lending and issues capital on the basis of the group's knowledge of the individual and the appropriate size of the loan.

H. Women gain a better understanding of how finance can make money for them and the value of that finance. By building their skills gradually, they develop improved sense of how the money can work for them and how much that money is worth. During a market study in 1998, the women indicated that a major constraint was the amount of money in the group fund or the need to rapidly rebuild the group fund after distribution. MMD groups indicated that they would be willing to pay 5-6% for money to get access to refinancing facilities. They based this on the fact that they were already paying 10%, so they could finance the 5-6% out of that 10%. This demonstrated that they had developed a logical rationale for proposing a price for the money and demonstrated their perceived value of the funds.

In this case, MMD groups who have successfully been through more than one cycle have proven their ability to organize themselves into reliable ASCAs. CARE introduced a refinancing program with the assistance of the French Cooperation in early 1999 for MMD groups that had completed at least two cycles. By the end of 2001, this pilot program had worked with over 150 groups and provided refinancing services to over 6,000 women, charging effective interest rates of 4.5% per month. The program has not been evaluated to determine the full negative and positive results.
from the refinancing, something that should be placed on the agenda.

I. The MMD methodology eliminates problems of allocation of the “scarce resources” to members of a group (in this case, access to the loan funds), since everyone benefits, no matter who takes the loan. Any individual participating in the program will get the benefits of increased value of their deposits by the same amount as each of the other members. Therefore, no one is left out. In some of the other MMD programs adapted in other countries, this issue has been dealt with differently. In Zimbabwe some groups pay out a different dividend to those who have borrowed compared to those who have not. They pay borrowers more than savers, on the grounds that the borrowers have made the biggest contribution to fund growth.

Limitations
The MMD methodology works very well in specific environments. Its simplicity makes it effective, but also adds some limitations that must be understood and accepted by the members. As programs adapt, the members of the groups usually address these constraints.

A. The funds start slowly but grow steadily. Members must wait 6-8 weeks before they can start borrowing from the fund, and then they start with small loans. This is not as immediately gratifying as getting a loan from an MFI, but if there is no other finance available, then this is the best option. In addition, the program is sustainable and has the double benefit of accessing loans while building up own capital through the repayments.

B. The methodology does not allow funding larger loans, making longer-term loans, or creating repayment mechanisms, as these go beyond the current capacity of the women to manage them. The flexibility of the methodology is inherently limited by the levels of literacy (and numeracy) of the groups and the outreach and training capacity of the implementing agency.
C. The disbursement at the end of the fixed period is an incentive for the women. But it also means that the loan funds disappear at disbursement, and the groups must start up again from nothing. This forces a compulsory credit holiday on members and can have a negative effect on their business activities. Since the disbursement date is usually set at a time of greater need by the women (just before the harvest, or before a big religious holiday), the women manage to spend or invest most of the funds from the disbursement. When the groups start up again, they will not have much more liquidity, but they will sometimes choose a higher weekly contribution.

D. The MMD currently functions outside of the regulated sector, which makes linkage to the formal financial sector difficult, should the groups ever decide to follow this course. This has caused problems for groups trying to link with formal financial institutions in Niger, where the regulatory environment sets limits on the interest rate (well below MMD’s 10% per month) and adds legal registration requirements that few MMD groups can meet.

E. There are limiting factors on the overall development of the organization and the types of markets that the groups can serve.

- At the low-end, MMD works very well in markets characterized above as: the landlocked rural with food-producing potential (category 2); rural accessible with cash crop production activities (category 3); and the peri-urban areas (category 4). It reaches deeper into the poor rural areas than any other programs the authors have encountered, but even so, there still appears to be a limit as to just how low the program can reach. In Niger, there are a few areas where the groups just have not been able to afford even the most minimal contributions on a weekly basis. So there must be a minimum level of economic and monetized activity.

- The program also has important limits at the high end, when members need larger loans. There have been some groups that contribute larger sums, but this means that all
of the women must be at the same level. There have been cases in Uganda where CARE has guaranteed individual members to go to banks to get larger loans. This implies that members must graduate out of the program, and it is uncertain whether they can do this without CARE’s assistance for a continued period into the future. Overall the methodology as it stands has definite boundaries at the top of the spectrum.

F. The program also has limits in terms of dealing with cash surpluses or cash shortages. Without any links to other groups, members of a group have no outlet for any funds that are not needed for loans. Similarly, if there is excess demand, members have no means of accessing further financing to meet their needs.

G. Finally, the program faces challenges if it tries to expand services to non-group members, for which there is always demand. It has not worked yet because there is a sense of losing control, and problems with bad debt, theft, malfeasance, and enforcement.

It is clear that while there are many limits to the MMD program, it is a very simple methodology and one of the purest forms of true financial intermediation to meet the financial service needs of poor rural areas. It is particularly well adapted to areas with weak economic activity that cannot be served by more formal institutions.

Institutional Development and Replication Issues

Financial Considerations and Sustainability
One of the most important strengths of the MMD is its sustainability. Though groups of 30 women do not fit the normal definition of a microfinance institution, they can be very easily established and can self-replicate without any additional investment beyond the initial group creation. In terms of the initial discussion on the scarcity of organizations that are able to deliver sustainable financial services, it is clear that the
program is well adapted to sustainably meeting financial needs in the poorer regions of rural Niger. The organizational structure is able to overcome most of the constraints that face traditional microfinance institutions in their attempt to deliver services. Once created, a group can continue forever.

CARE’s role in the MMD is not one of service provider, but of catalyst. CARE has developed the methodology and provided the initial training, but now these roles are being undertaken directly by other, slightly better educated, village women. The program has learned that it can divest its training functions more quickly by promoting the development of the local animators. In similar programs in other countries, CARE has learned this lesson and is able to move more rapidly to local sustainability. As a catalyst, CARE’s costs per group created are very low.

Costs of group creation. The costs of creating a new group are decreasing. Early in the life of the program, costs were well over $1,000 per group created ($33 per member). Innovations have brought development costs for mature programs to between $18 and $25 per member. Innovations include speeding up the training process (Zimbabwe has reduced it to one week), keeping the methodology simple, and using local resources for the training (locally hired agents, paid for by the women themselves). As the groups are immediately self-funding, there is no need for on-going subsidies in order to maintain the groups, so the only real cost is at start-up, as well as any monitoring costs that might be deemed appropriate. As noted above, CARE’s team is no longer doing direct training of groups, but is rather training local members how to train new groups. The group members pay these trainers, so they are no longer a cost to CARE. While the quality of the groups appears to be as good as the CARE trained groups, CARE has not been monitoring them effectively to know just how many groups have been created.

Once the members of a group have been trained they can (and do) auto-replicate year after year. In a 1998 evaluation in Maradi, CARE found that 96% of the groups created since 1991
were still functioning, but that numerous other groups had also been created alongside them. In a 1999 evaluation, CARE found that 100% of the groups created since 1994 were still operating in Tahoua. An additional point of leverage for creating more groups is that after the distribution and disbanding of the group, when it re-forms, it very often will re-form as two separate groups. In this case, some members split off and each group adds new members. The quality of these groups is as good as those that are formally trained. The costs per member of training by a facilitator, paid directly by the members, is about $3.

Management and operating costs. The operating costs of the program are kept very low. The groups are self-managed and have demonstrated the need for little or no record keeping. The newer groups pay for a local trainer to visit them on a regular basis during their start-up to ensure that they are respecting the fundamentals of the program. Loan evaluation is carried out by the members based on their knowledge of the individual taking the loan, her ability to manage the funds, and their understanding of the business opportunity. Since the loan is usually guaranteed in part by the savings, there are no collateral costs. Besides this, there are no other management-related expenses, so all of the proceeds stay within the groups.

As each of the groups is a stand-alone organization, it is an excellent example of a truly decentralized system. Though there are over 5,500 groups who identify with the MMD methodology, each group is completely autonomous. The members make all management decisions and there are no referrals or links that must be made to other organizations in order to run the day to day business. This eliminates the costs associated with travel and communications that one finds in devolved organizations like traditional savings and credit unions. Since the funding is all generated within the village, neither are there any costs associated with getting and repaying funds.

Opportunity costs. There are opportunity costs associated with the program. In Niger, where the women meet weekly, there is a significant time commitment. However, the
economic opportunity cost of this time appears low, particularly since the women enjoy the interaction. In situations where clients have limited time, the standard weekly-meeting approach can pose a challenge.

Clearly, the program has been able to address most of the issues that prevent more formalized and centralized organizations from becoming cost effective. However, there is a continued need for CARE’s catalytic role to monitor the progress and to understand the dynamics of the growth of the system. This will allow them to capture the lessons learned and distill them for further enhancement of the methodology.

**Group Dynamics and Methodological Adaptation**

CARE has replicated the MMD model in a number of countries, including Mozambique, Zimbabwe, Malawi, Zanzibar, Mali, Eritrea, Rwanda, and Uganda. In most of these cases, the project did not start specifically as an MMD-style project, but rather as an existing project incorporating the MMD methodology. Sometimes, this has meant that there has often been a dual process of unlearning the old project methodology to match the challenges of learning the new one.

Each project has been adapted to specific conditions. While groups in Niger, Eritrea, Rwanda, and Mali are for women only, Uganda, Zimbabwe, Malawi, and Zanzibar have mixed gender groups. There is one of each in Mozambique. The sizes of the groups vary by country as well, between an average of 33 in Mali and an average of six in Zimbabwe. There are differences in all aspects of the program depending on the country. The frequency of meetings (between monthly and weekly), flexibility of contribution, degree of pay out at the end of the cycle, length of the loan term, and the average interest rate (between 5% and 20%) vary by country.

The program in Zimbabwe has made major modifications to the process, reducing the frequency of the meetings and clustering the groups. While the MMD in Niger works very well in rural areas where there are 2-3 people per square kilometer, the people are clustered in villages. The Zimbabwe
adaptation was a response to the low population densities, where people are very dispersed, living on their farms and not in villages. In this case, the opportunity cost of attending the meetings increased, so reducing the frequency of the meetings was important. Despite the small group size (average of six members) this adaptation allows the program to have the second highest client to staff ratio of all the programs. Reducing the group size and the frequency of the meetings has also resulted in higher than average levels of group solidarity and attendance. This adaptation turned out to have a positive effect on group solidarity without any negative effect on the amount of loan funds available.

But even within countries, there is often considerable variation in the way that individual groups operate, often times without the knowledge of the project staff. As noted above, the methodology has evolved steadily since its inception, both from the project staff as well as from the members. CARE staff have been most concerned with process, but the members are most concerned about their own well-being and with improving the responsiveness of the product to their own personal circumstances.

The adaptations from the core model include both financial and process issues. Financial innovations include widely differing ways of structuring repayment (principal and interest), variability in the length of loan term, and different ceilings for different types of investment. There are also variations in the frequency of meetings, different lengths of the cycle, different criteria for borrowing, establishing sub-group meetings to speed up the “plenary” meetings, packaging sub-group loan requests, etc.

MMD-style programs need to document the latest innovations and ensure transfer of these ideas. Given the level of sophistication of the CARE field staff (who are primarily animators, not financial specialists) and the large numbers of groups per staff member, field staff are often slow to notice when changes are incorporated. This is especially true in
well-established programs with many clients. This makes it difficult to track the evolution of the model, which is still an important function.

Replication Issues
MMD is still a work in progress. The explosive growth in Niger took nearly a decade to achieve. This growth of members appears to be happening much more quickly in Zimbabwe, but it is still too early to know if it will ever reach the size and scale of Niger, where MMD members equal three percent of the population.

Financial services are one part of CARE's core mission, in order to allow to achieve their overall mission of poverty reduction and alleviation. As such, they have not actively driven the promotion of the methodology, either onto the world microfinance agenda, or even actively into each of its country programs. Even though the MMD approach for providing microfinance services to rural poor has proven its strengths and effectiveness, the model does not become an automatic choice for all CARE country offices for implementation. Each country program is driven by its own program environment, priorities, and funding base. Only when there has been a fit for the program within the larger country program has MMD been introduced, either as a new program or as an adaptation within existing program.

It is clear that once MMD reaches a critical mass within a region, the demand for the product is enormous. This leads to demand driven replication. One issue for further exploration is to understand how to take advantage of the demand once a critical mass is reached (and what should be done if a critical mass is not reached).

Some of the major issues for replication across countries are how to share the information and how to attune the program to the local environment. This has implications for group size, group formation, amount of time spent on group formation, interest rates charged, etc. Historically there has been little systematic sharing of information between the country
programs to see what methodological process adaptations have taken place, how the CARE project teams are structured, and what adaptations have taken place at the membership level. But this is changing and CARE is investing more in promoting cross-fertilization of country programs using the methodology.

Other Challenges Facing the MMD

As with most microfinance, regulatory issues eventually come to the fore. MMD faces challenges of working within the legal and regulatory structure, but is usually able to circumvent it. Small ASCAs usually fall below the radar screen of the regulators, so they are a good way to circumvent constraining regulatory environment. However, once they get as big as MMD, governments do not dare to try to limit them.

The regulatory issues still put limits on the potential for future development into the formalized financial sector. Perhaps the best way will be for the formal sector to take the initiative. When considering the size of the savings that are being generated ($3 million in Niger), they might find it to be an interesting proposition.

Networking is one way to overcome this challenge. The program has begun to form local networks and is seeking ways to register the networks; currently six networks are registered in Niger. This allows them to access synergistic financial services from other systems (such as credit unions) that can help address some of their limitations. The challenge is how to do this cost-effectively.

Conclusions

CARE Niger’s MMD program has reached unparalleled scale and depth of outreach in one of Africa’s poorest countries by developing a very simple and efficient methodology that responds to the financial service requirements of the individuals in some of the poorest rural areas. With an estimated $3 million in aggregate savings, a similar amount in loans outstanding, and 162,000 group members, MDD provides
excellent financial intermediation and keeps the money in the community. It provides both savings services as well as credit. It is completely sustainable and requires no outside assistance once the group is established. The methodology is highly replicable because it is simple, appeals to common sense, and is inherently transparent. Above all, it does not require the establishment of a complex institution, such as an MFI, or require a specialist organization to implement.

In Niger, the CARE team has refined the methodology and adapted their training approaches to reach large numbers of new groups without their direct involvement. This adaptation took many years, through trial and error, but has been very effective. Perhaps one of the important aspects of its eventual success is that non-financial specialists developed MMD, who were effective listeners and made an instinctive attempt to fully understand the context. It has not been over engineered and made too sophisticated for the members. Keeping it simple and responsive has been a major part of its success.

CARE is in the process of gradually replicating the methodology into other countries. It recognizes that in most countries where the program works, there exists a traditional form of financial intermediation mechanism (Tontins in Western Africa, Merry-go-round in Kenya, Chilimba in Malawi, and KixiKila in Angola) that people understand and trust. Each country refines the program to fit its own circumstances, but this still involves a fair amount of trial and error. One of the important elements in the adaptation by country is that the members are very involved in the adaptation and in the decisions about group size, gender composition, loan terms, and interest rates. At the end of the day, these groups belong to their members, so their operating principles must respond to the needs of the members.

The MMD approach is one of the best examples of a completely decentralized financial organization. It is really a
movement rather than a single organization, but it moves ahead with each of the groups making their own decisions and carrying out their own policies. Because it is self-funded and the members ensure the management, there are virtually no operating costs associated with the group. This allows it to function in extremely weak economic environments, where other financial institutions cannot afford to operate. Because all the benefits from interest paid on loans accrue to the members, there are few constraints to charging higher interest rates, which allows the return on investment to keep up with inflation.

The success of the program is directly attributable to the responsiveness of the product to the members' needs, as well as control by the members. It provides them with desired savings and credit services, while the only costs to access those services are patience and some of their own time. Because there is no leakage/outflow of funds outside of the group, all of the benefits accrue to the group, encouraging the members to respect the rules of the group. Since they are borrowing their own money, moral hazard is drastically reduced to the point that there is virtually 100% repayment among the MMD groups.

Finally, the methodology is being constantly pushed and adapted by its members. The MMD model works even where literacy levels are low. In communities where financial literacy level is higher, a different range of solutions are available to the members because they have a greater level of financial sophistication (Zimbabwe). In addition, as the program develops and members have been through several cycles, their level of sophistication increases, making it more feasible for them to introduce new adaptations to the methodology. On the other hand, simplicity of the approach makes it that much easier for the neighbouring communities to self-replicate with minimum external support.
References


Notes

1. While CARE has directly facilitated the creation of over 5,500 groups with about 162,000 members, there are many more women who have organized MMD groups on their own, either from disbanded groups or with the help of the training facilitators who are no longer served by CARE.

2. The monograph by Hugh Allen, “CARE International’s VS&L Programme in Africa—Microfinance for the Rural Poor that Works” will soon be printed.

3. Though savings and credit unions are commonly thought of as decentralized structures, they are still centrally organized, the central management makes most important decisions, and they have a heavy infrastructure to support. This limits their ability to be cost-effective in a relatively weak market.

4. While this is not necessarily intuitive and the evaluation was not done in a statistically sound manner, the interviews with the different women’s groups about their internal operations demonstrated this difference.
The New Microfinance
An Essay on the Self-Help Group Movement in India
by Kim Wilson

Abstract: Indian NGOs have created at least one million self-help groups with 17,000,000 members since the self-help group concept was developed by MYRADA in the late 1980s. India is unique in that banks are permitted to lend directly to unregistered self-help groups and by May 2001, banks and cooperatives had financed 461,478 of these groups, with almost 200,000 new self-help groups financed between May 2000 and May 2001, indicating an accelerated process of expansion. The National Bank for Agriculture and Rural Development (NABARD) trains banks and refines their loans. The key to NABARD’s success is decentralization. Responsibility for group development and training is devolved to NABARD’s 2,100 NGO partners and almost 450 banks and cooperatives provide banking services to the groups. According to the Microcredit Summit Report, 2,663,901 of the 6,651,701 active members of the groups financed through NABARD (most of them women) were categorized as “the poorest,” making NABARD the largest microfinance initiative in Asia, with Grameen Bank a close second. (If the number of members of self-help groups not linked to bank financing are included, the number of the poorest being reached through self-help groups is at least double.) Local costs per group member to train and support a group until it can operate independently range between $4 and $12.

Late in the monsoon season in a coastal village of Orissa, I searched for a banker with whom I had an appointment. I located him standing in a watery rice field, trousers rolled to his knees, chatting with a group of women who had stopped long enough
from their work to listen. He was telling them how sorry he was that he could not, as yet, issue their self-help group a loan. Their records were not up to par, he told them. But he was pleased to note that repayment of loans from group savings was always on time. He suggested members contact a retired bookkeeper in the village, a friend of his, for help. He assured the group that once its records were good, the bank would issue a loan. After all, he had already issued loans to eighteen other groups in the village area. The women smiled. He unrolled his trousers, put on his shoes, made his way up the grassy bund, and walked me back to his village office.

This is a simple story and not particularly exciting. But it is new, new in the sense that this story repeats itself day in and day out across hamlets and villages throughout one of the largest countries in the world—India. It is a story that deserves recognition and a chance to make its way to other countries and to other women.

The new microfinance espoused herein rises from recent innovations in India and their impact, closely observed, on the lives of villagers. In light of what passes for microfinance around the world, these observations urge us to listen to our intuition: something good is happening out there and it is big.

The new microfinance is not really new at all. It is a reordering of parts in India’s financial machinery so that it calibrates to the needs of the poor. This new order of things—formal and informal, social and financial—separates the new microfinance from the old.

What are the differences? Complex rules, practices new to the client, and credit power the old microfinance. Simplicity, traditional practices, and thrift power the new. The old microfinance aims for an institution to sustain itself through a push toward profit. The new microfinance aims for groups to sustain themselves through the pull of social benefits. "Best
practices" from an institutional perspective drive the old microfinance. Breakthrough client experiences drive the new. Out with the old. In with the new.

**Unnatural Acts**

The old microfinance is unnatural. It asks bankers to become social workers or social workers to become bankers. It requests NGOs to transform into financial institutions and then to persist in reaching a market that, for them, is not profitable. True, microfinance institutions have reached many people left behind by conventional banks. But at what cost? At what subsidy?

Let us do the math: take the needed investment in loan capital, often with a high threshold set to the laws of a particular country. Now add to it initial operating subsidies, a few big investments like information technology and branch office buildings, fees for international consultants, travel expenses for these consultants, and in many instances, an endless stream of operating losses. Catholic Relief Services (CRS) has seen an average annual investment per client in a sponsored microfinance institution (MFI) climb as high as $350.

Very high interest rates for clients are needed to cover all institutional expenses because, save the income from microfinance clients, the MFI has no revenues to cover costs. This equation, by any measure, is the math of failure.

**Natural Acts**

India has a better idea: the new microfinance, which links traditional wisdom rooted in the self-help model—and refined by pioneering NGOs, such as MYRADA—with the financial power of a network of 150,00 bank branches.

Here is how the new microfinance works. Promoters—field staff of NGOs, bank staff, or volunteers (often group members themselves)—reach out to women, gather them into groups of twenty or fewer—and encourage women to save weekly or monthly. Sometimes they save as little as five rupees...
(US$0.10) per month. Promoters show groups how to lend their collective savings for a variety of purposes, ranging from loans to buy a few chickens, pay school fees, or finance emergency medical care of a child. Promoters also instruct groups to properly record saving and lending transactions. After groups stabilize and are able to perform a variety of group management activities, promoters link them to local banks, where they may receive a group loan.

In this model, promoters organize people, motivate people, and find the poorest ones to serve—activities they do well. For them, these acts are natural. India’s network of 150,000 bank branches is able to provide credit and savings services. Banks manage liquidity, analyze portfolios, calculate reserves, and collect payments. Banks already do these functions, so doing them for a new market niche poses a few challenges, but no major obstacles.

There is a third player in this model: NABARD, the National Bank for Rural Development. NABARD refinances the portfolio of state and commercial banks at an interest rate of 7.5%. This refinancing releases banks from mobilizing their own deposits to lend to untested groups of women. It is a stimulus, a good role for a national bank.

A fourth player is the Panchayat Raj Institution (PRI). The Panchayat Raj is an important local governance structure with resources and political seats allocated to villages and village clusters. Emboldened members of self-help groups run for local office and draw political rights and economic resources into their villages. Group members attract biogas infrastructure; funds for bridges, wells, and roads; and structures for schools and health centers. The Organization for the Development of People (ODP), in Mysore, Karnataka, reports that in one district, 179 self-help group members ran for local and district office. Of these women, 73 won seats in local office and 2 at the district level.
For each of these players, these acts are natural, and together they shape a good idea. But for India to have a good idea, it must be a big idea.

While the SHG movement in India represents the largest microfinance initiative in the world, with over 1,000,000 self-help groups with 17,000,000 members formed—the magnitude of the work yet to be done in this nation of 1.1 billion people is staggering. In India, 70 million families—between 350,000,000 and 400,000,000 people—live below the poverty line, and at least 75 million families could make productive use of microfinance services. This is more than three times the number of families currently reached by all of the microfinance institutions in the world. (Ashe, 2002)

Three Models of Linkage

The NABARD refinancing program, piloted in 1992, is one of several in India. Currently, NABARD refinances loans generated by 17,085 bank branches throughout the country, yielding a branch penetration of 11%. With plans to reach one million SHGs by 2008, NABARD's annual growth predicts success. Whereas refinancing reached 25,000 new self-help groups in 1998–99, it reached 200,000 new self-help groups in 2000–2002. NABARD partners with 444 banks and a network of 2,155 NGOs and independent agents.

Three models of linking self-help groups to banks have evolved over time. Model 1 encourages banks to form and finance self-help groups. Model 2 encourages NGOs to form groups giving small cash grants and training as an incentive and then link them to local banks. Model 3 finances NGOs forming self-help groups to intermediate loans to groups.

From the point of view of CRS, Model 2 is most advantageous to local nonprofit partners. CRS has development partnerships with 2,500 grassroots organizations across India. Most are small, local entities, often social extensions of the Catholic Church. Partners work in isolated areas of the tribal
Table 1. NABARD Models for Linking SHGs to Banks

<table>
<thead>
<tr>
<th>Model</th>
<th>% of Linkages</th>
<th>A Few Advantages (each model compared to the other two)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model 1: Banks form and finance SHGs</td>
<td>16%</td>
<td>Lower cost of group formation, but groups may form for sole reason of receiving bank loan and disintegrate more quickly (Srinivasan, 2000); slightly better repayment rate (Puhazhendi &amp; Satyasai, 2000).</td>
</tr>
<tr>
<td>Model 2: SHGs formed by NGOs and financed by banks</td>
<td>75%</td>
<td>Can reach poorer SHG group members; greater percentage increase in net assets of members; greater increase in net income (Puhazhendi &amp; Satyasai, 2000).</td>
</tr>
<tr>
<td>Model 3: NGOs, MFIs, and group clusters are financed by banks and intermediate loans to SHGs</td>
<td>9%</td>
<td>Higher (slightly) portion of poor members crossing poverty line (Puhazhendi &amp; Satyasai, 2000). Convenient for banks interested in bulk loans, but could cost members in form of higher interest.</td>
</tr>
</tbody>
</table>

belt, which stretches east to west and north to south in two great bands. Tribal villages, often composed of disparate hamlets, make the task of amassing large concentrations of SHG members a challenge that rules out Model 3.

The Process of Group Development

NGOs and banks define the group development process in many ways. Even among CRS partners, ideas vary about stages
Table 2: Financial Development of a Group

<table>
<thead>
<tr>
<th>Phase 1: Savings</th>
<th>Phase 2: Interlending</th>
<th>Phase 3: Bank linkage</th>
<th>Phase 4: Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Group chooses a common amount to save each month (typically between US 5 cents and 50 cents per member)</td>
<td>• Savings continue</td>
<td>• Savings and lending continue within group</td>
<td>• Group manages savings, internal lending, bank credit, and bookkeeping without subsidized support</td>
</tr>
<tr>
<td>• Group opens a savings account at a nearby bank</td>
<td>• Group lends savings to members (charges interest)</td>
<td>• Group approaches bank for credit, up to four times the amount saved</td>
<td>• Group continues indefinitely (as long as members enjoy benefits)</td>
</tr>
<tr>
<td>Benefits</td>
<td>• Basic bookkeeping begins</td>
<td>Benefits</td>
<td>Benefits</td>
</tr>
<tr>
<td>• Discipline of thrift, creation of assets</td>
<td>• Groups learn to lend and borrow with small amounts of cash at stake</td>
<td>• Group develops relationship with mainstream financial institution for permanent credit access and savings services</td>
<td>• Group can borrow up to four times savings</td>
</tr>
<tr>
<td>• Dependence on money-lender reduced</td>
<td>• Dependence on money-lender reduced</td>
<td>• Dependence on money-lender reduced</td>
<td>• Dependence on money-lender reduced</td>
</tr>
</tbody>
</table>

of group development. CRS uses the simple outline below to define the financial development of a self-help group, which typically passes through several phases, as outlined in Table 2. Phase 3, "Bank Linkage," is optional; a group enters this phase only if its credit needs outstrip its available savings.
Figure 1. Socio-economic Activities of a Group

| Sustainable Farming and Forestry (Sharing of improved techniques) | Income Generation (Encouragement and advice on individual activities of members) |
| Watershed Management (Water users groups, infrastructure maintenance) | Social Evil Eradication (Alcohol abuse, spousal abuse) |
| Education (School for children, adult literacy) | Disaster Preparedness (for recurring natural calamities) |
| Socio-economic Activities of Self-help Groups | Peace (Interfaith, interethnic, intercaste tolerance and conflict resolution) |
| Microfinance (Savings and credit) | |
| Civil Society (Women members run for elected office) | |

The financial development of a group sustains the group over time so that its members may enjoy social benefits. CRS believes that social action and social change justify our subsidy. Again, the social development of self-help groups varies widely. Often, development is driven by group priorities. Just as often, it is driven by NGO imperatives. Figure 1 illustrates the types of activities in which self-help groups engage.

A group’s social development passes through several stages. Depending on the locale and the make-up of its members, financial and social development of a group takes one to four years before the group reaches financial and social sustainability. Literacy rates and proximity to major travel routes cause the greatest differences in time needed to form groups and the cost of their formation. CRS partners in remote tribal areas of the Northeast and Eastern Ghats claim that scheduled castes and tribes (the most disadvantaged communities) require much more support in group formation than do more literate groups.
located close to populated areas or well-traveled roads. Expenses per group from mobilization to self-management range from $0 (in instances where volunteers and group members form new groups) to $100-$200 (where an NGO forms the group). On a per member basis, this subsidized cost of $6-$12 compares favorably to the $350 of subsidy required to get an MFI up and running before it becomes profitable.

Why Banks Participate

As of August 2002, India’s private and state banking systems had extended more than $1 billion (5454 crore) in loans reaching 7.8 million households through self-help groups. For banks, the advantages of offering services to self-help groups range from risk diversification to incremental profits. The NABARD refinancing program allows banks to fulfill a legal requirement without using its own deposits. But more importantly, groups make excellent customers. They generate a low rate of nonperforming assets (less than 1%) and a high repayment rate: +95%, versus a much lower rate for routine commercial and individual lending. (Recent data shows that as of August 2002, 28% of bank credit extended to self-help groups is not refinanced by NABARD. Banks are choosing to finance groups with their own funds.)

Unlike typical bank customers, who borrow sporadically, groups borrow steadily and tend to increase their borrowing as their savings grow. In fact, the average loan balance of a self-help group is Rs. 22,240, up 22% from the $463/Rs. 18,227 balance of the year. The average balance of individual rural customers is about Rs. 10,500 per customer, or US$210. For banks, the interest income potential from groups is promising.

Groups save and deposit surplus savings—those savings not rotated as loans to group members—into a group bank account. These savings improve bank liquidity. A recent draft report notes that of 121 households surveyed in two states, 26% of "SHG households" polled in Orissa used bank savings services in contrast to only 15% of "non-SHG households." In
Karnataka, the contrast is more striking: 34% of SHG households use banking services, as opposed to 7% in non-SHG households (GTZ, 2002).

Group linkages also bring unexpected benefits. Some banks find that as groups start to borrow, they clear old debts. Wives of defaulting husbands encourage husbands to repay late loans to preserve group status with the bank. Self-help groups represent incremental revenue, revenue beyond the bank’s core income streams. Because most banks cover fixed costs with interest and fees from corporate or individual customers, self-help group interest, once variable costs are subtracted, goes straight to the bottom line. Bankers interviewed by CRS see groups as profitable or potentially profitable. Moreover, to earn this profit, banks lend to groups at interest rates of 12–13%, far lower than rates typical of an MFI.

**Why NGOs Participate**

CRS understands that the new microfinance means every institutional actor plays his rightful role. Grassroots organizations usually have good community contacts, knowledge of local languages and customers, and the patience and skill to organize groups of people who may be of disparate faiths, ethnicities, castes, and classes, who may be a camel ride from a good road, or a river trip from the nearest bus depot. Plus, grassroots NGOs know that they do not have what banks have—staff trained in managing cash, in conforming to regulations, in forecasting reserves, and in minimizing fraud. CRS partners claim they are glad to concentrate on “social animation” and leave the provision of financial services to banks.

In the MFI approach, the institution itself aims for self-sufficiency as a means to stay viable. Viability calls for high interest rates, often in excess of 3% per month, and relatively large loan amounts ($50 or more), ruling out the poorest as clients. The very poor have trouble managing large amounts of debt and, in many cases, are averse to taking the initial risk of borrowing. In the self-help group model, the NGO seeks
self-sufficiency at a group level with self-sufficiency defined by CRS and partners as "unsubsidized group self-management." Because loans originate from group savings, with groups absorbing transaction and tracking costs, members need not set high loan minimums. Such flexibility allows the poorest to borrow extremely small amounts—tiny chunks of debt well within a member's capacity to manage. Unburdened by the yoke of institutional self-sufficiency and utilizing a methodology that costs only a fraction of starting an MFI, CRS partners can penetrate the heart of India's tribal belt and bring services to remote villages and hamlets. Without the pressure to cover costs with internally generated income, partners feel free to bring news to groups about low interest loans, affordable insurance, and other financial services.

Sustainability, while taking into account self-sufficiency, means far more in the Indian context than in most MFI scenarios. As MFIs have evolved, self-sufficiency has gained primacy as the key indicator of sustainability. Data on desertion rates around the world, however, show such a definition to be inept. As MFIs churn their clients, their victory in gaining new clients is Pyrrhic. MFI performance in Africa shows that in some instances, annual dropout rates are as high as 60% per year (Wright, 2001). Lost profit streams siphoning unchecked from an MFI will guarantee its failure. In contrast, data on dropouts of SHGs, though scant, show a surprisingly low rate of desertion. According to internal reports from CRS partners and the author's own observations of more than 250 self-help groups, a group of twenty loses less than one member per year.

In the context of self-help groups, CRS and its partners prefer a definition of sustainability that approximates reality more closely. That is,

Unsubsidized group self-management
+ Benefit stream to each member
= Sustainability.
Table 3: Opinion on the utility of SHGs

<table>
<thead>
<tr>
<th>Perceived Utility of SHGs</th>
<th>Age of SHGs (in years)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2 or less</td>
</tr>
<tr>
<td>Source of consumption loan</td>
<td>96%</td>
</tr>
<tr>
<td>Source of production loan</td>
<td>46%</td>
</tr>
<tr>
<td>Link to get loan from banks</td>
<td>79%</td>
</tr>
<tr>
<td>Ability to solve social and community problems</td>
<td>45%</td>
</tr>
<tr>
<td>Elevates social status</td>
<td>51%</td>
</tr>
<tr>
<td>Link to other agencies and government</td>
<td>40%</td>
</tr>
</tbody>
</table>

The key to this simple equation is the benefit stream—derived internally from the initiative of members and externally from opportunities introduced by NGOs and government—that accrues to each self-help group member over the life of a group. While MFIs do indeed provide benefits, evidence suggests these benefits are short-lived and inadequate to retain loyalty in the long run. Local self-sufficiency—meaning the ability of a group to manage its affairs without subsidized support—twined with an unbroken chain of benefits would be a far better proxy for sustainability than the vogue for more “precise” measures of financial self-sufficiency.

Why Members Participate in Groups and in Bank Linkages

A healthy self-help group offers each member a steady stream of benefits. Together these benefits ensure that the group will sustain itself for as long as its members value participation. Table 3 (Puhashendi, Satyasai, 2000) indicates changes in what groups value, depending on the age of the group.

CRS observations indicate that benefits are diverse and vary not only by beneficiary, but also by locale.
Instant Benefits. CRS partners have observed that members see value in gathering with other women to meet and talk. They also value the practice of thrift: the chance to put aside small amounts of cash or grains they can quickly convert to cash. Thrift differs from savings (accumulation of surpluses). Thrift implies small sacrifices. SHG members, even the very poor, can practice thrift by putting aside a measure of rice each day or week and converting that rice to cash when their group deposit comes due. Women see the benefit of motivating one another to practice the discipline of thrift, even in lean times, for a future gain in the form successively larger loans.

Another widely cited reason for gathering into groups is to receive information—how to save, where to find a rural extension worker for agriculture, which government schemes work, what income generation opportunities offer profit. In many cases, groups report that an even supply of news is important in all phases of group evolution. When asked informally, members respond that valuable information includes news about health resources, farming techniques, the latest methods of sustainable energy, and possibilities for income generation, like mushroom cultivation and auto-rickshaw operations.

Interim Benefits. We have observed that thrift satisfies members for a few months. In some tribal areas (for example in Phulbani District, Orissa), the practice of thrift at the modest scale of a few rupees per month sustains groups for more than ten years without other apparent practices or benefits. Most groups, however, move on to a second benefit: internal credit. Members borrow from the group fund for many purposes—consumption during lean times; medicine and doctors for household emergencies, household and farm improvement, and income generating initiatives. If credit needs outstrip supply from the group fund, groups may avail further credit by a factor of four through a local bank (the NABARD program explained previously).

Long Term Benefits. CRS partners and former partners have had hundreds of groups functioning for longer than eight
Table 4. Sample Task Forces of Self-Help Groups

<table>
<thead>
<tr>
<th>Task Force</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panchayat Leadership</td>
<td>To run for local and district level office, to represent village interests, and to claim needed resources at the village level.</td>
</tr>
<tr>
<td>Health Development</td>
<td>To avail village of health and sanitation practices, and attract government resources (health workers) for primary health care.</td>
</tr>
<tr>
<td>Environment</td>
<td>To develop sustainable natural resource management practices, and to attract government resources (funds for infrastructure), and training sessions (e.g. biogas).</td>
</tr>
<tr>
<td>Economic</td>
<td>To oversee financial health of group and equity in the issuing of loans. To inform group of training in income generation by government and other SHPIs.</td>
</tr>
<tr>
<td>Education and Literacy</td>
<td>To ensure basic literacy of each member. To ensure every boy and girl child attends school in village.</td>
</tr>
</tbody>
</table>

years. These groups claim they still benefit from savings and credit but find meetings hold a more powerful purpose: to gain and share information, to take social action, and to link to government resources.
Groups as Catalysts of Social Action

Powered by financial activities—where poor women save regularly in a group fund, lend savings to members, and finally link their fund to a bank for additional credit—self-help groups, wisely engaged, are a route to peace, equity, and a just and civil society. Groups also act as agents of information and change. They prepare communities for natural disaster and lessen the impact of diseases such as tuberculosis, malaria, and HIV/AIDS. While the model’s benefits are many, its financial activities sustain it and make a group’s many and varied social gains possible.

In Mysore, Karnataka, CRS partner ODP, sees social action as the objective of self-help group promotion. ODP has organized its 20,000 SHG members so that each group includes small task forces with counterparts at the village level. Table 4 shows typical task forces and their objectives.

A recent study commissioned by a CRS partner in Tripura indicates groups are active in community development and peace building (Ramchandran & Ambroise, 2002). Mass violence and tribal conflict characterize this small state that borders Bangladesh, so communal activities across groups and tribes are very important. The study reports high participation in social justice activities. They have assisted in the release of wrongly accused victims from the local police (32%) or in campaigning against the use of alcohol (44%). Women make up 80% of group membership, proving they are unafraid to confront worthy social causes.

In addition:
- 71% of groups have installed latrines for community use
- 54% have helped construct village roads
- 98% have helped establish preschools
- 99% have helped establish elementary schools.

Scale and Additionality

The pliability of the SHG model is such that taboo practices in the old microfinance become possible, even practical, in the
new microfinance. For example, an organization with no intention of reaching many clients, with a multiservice orientation, and with services targeted to a specific population would be unwelcome in the old microfinance. St. Paul’s Trust in Samilkot just a few hours from the coast in Andhra Pradesh performs “worst practices” if seen through the old lens. But, by a different standard, a standard that looks at service, St. Paul’s Trust is a success.

Founded in 1989 by Dr. I. K. Jacob, St. Paul’s Trust dedicates itself to helping women who are infected or affected by HIV/AIDS. Samilkot borders a well-traveled truck route and has a high prevalence of HIV/AIDS. Dr. Jacob administers a variety of medical services to these women, ranging from testing to treatment to counseling. About eighteen months ago, Dr. Jacob began organizing women into self-help groups. Dr. Jacob and his staff gathered 100 women into self-help groups. Half of the members are HIV positive; the rest have HIV-positive family members, many of them very sick. SHG members under Dr. Jacob’s care have designated family members to take their place should they die or become too sick to continue. Designees claim they will help repay loans and will continue with savings practices.

Of special note is the spontaneous marketing of the self-help group concept that emerged. Members of these groups report that local villagers have approached them, repeatedly. These villagers, healthy themselves and with healthy families, asked St. Paul’s Trust groups if they could join as new members. Because most groups were already too large to take on new members, groups have agreed to help villagers to form new groups.

The St. Paul’s experience signals how an inappropriate actor in the old microfinance has a valuable place in the new one. The simplicity of the self-help model and the removal of self-sufficiency as a requirement allow multisectoral NGOs to participate. Such simplicity also allows an unspecialized NGO, such as St. Paul’s Trust, to provide quality services as an
addition to its core objective (in this case, to treat HIV/AIDS affected women) and core services. Moreover, the easily understood benefits of the new microfinance allow the concept to spread easily among villagers so that coverage does indeed take place, but not necessarily directly by field staff. In this case, members’ own word of mouth satisfaction and a willingness to help other villages is the chief form of promotion.

The Ripple Effect

Venkat Ramnayya established Youth for Action (YAK), near Mahabubnagar, Andhra Pradesh, to promote village development focusing on agriculture. Ramnayya began creating self-help groups as a way to sustain his conservation farming agenda. To stem migration in the drought-prone area in which the organization operates, YAK raises quick-growing teak trees, processes neem into beneficial health and agricultural products, promotes vermi-composting, instructs in brick-making and methods of grafting, and harvests rainwater through clever, low cost housing designs.

Ramnayya initially promoted self-help groups personally by gathering village volunteers who came to YAK's model farm. He instructed volunteers on savings, credit, record-keeping, and bank linkage opportunities. His aim was to help finance sustainable agricultural activities promoted at the model farm. With access to savings and loans, villagers could invest in drought mitigation measures.

Trained volunteers, each a member of a self-help group, have since formed hundreds of groups and helped link them to local banks.

Volunteers first organize members in their own hamlets into groups and clusters of groups. They then find counterpart volunteers in other villagers and train them. On average, each volunteer interviewed had formed her own group plus one other. Groups also develop their own bank linkages. Villagers pay the expenses for volunteers who attend training sessions in
government schemes, sustainable agriculture courses, and self-help group strengthening sessions. When asked why they form self-help groups, volunteers responded they did so for the prestige of bringing “important services to their villages.” These benefits warrant working about three hours per week to promote SHG responsibilities. Ramnayya does not know exactly how many groups have formed and has no intention of tracking this number. Since no external donor funded the self-help group effort, YAK’s founder feels no pressure to report on “microfinance” activities. He concerns himself with sustainable agriculture.

Serving the Natural Village in Emergency Prevention

The natural village is a village defined by its watershed, the slope of land, and the pull of gravity on rains and upland springs. In India, nature forces village inhabitants to continually address the flow of water, the lack of water, or disturbances from cyclone, tremor, and landslide. The natural village in India is apart from the revenue village, the ruling construct that defines government resource allocation and political votes. But the natural village rules supreme in circumscribing rhythms of rural life and figures largely in managing emergencies.

The 1991 census (the 2001 census is not yet available) shows that 628 million people depend on farm incomes. These incomes rely on a monsoon that releases too much or too little water. Self-help groups made up of farming families are often part of a village that experiences recurring weather-related disasters, particularly drought and flood. Proper management of the natural village, then, is a form of insurance, protecting farm assets, food, animals, and people.

Self-help groups can and do serve as a means for mobilizing the natural village, including its web of tiny hamlets, to lessen the effects of natural hazards. In West Bengal, using self-help groups as a springboard, Catholic Charities Krishnanagar
(CCK), a CRS partner, provided disaster preparedness training in 300 villages. By using a participatory learning and action methodology, staff of CCK reached villagers in three districts, all flood prone and devastated by rains in 2000. As a result of these activities, (1) families feel more confident in managing a potential crisis, (2) families have changed animal raising practices and cropping patterns (to pre-September harvests) to avert flood impact, (3) communities have created infrastructure to prevent loss of life (raised platforms and school-based shelters), (4) families have reserves of grain in protected bins and important documents sealed in plastic, and (5) women have been highly active at Gram Samsad meetings to effect important policy changes and to attract resources (roads, bridges, and wells) to their communities.

Self-help groups rank disasters according to potential impact and create plans to respond to them. Early warning systems, planned rescue procedures, and plans for the immediate protection of a community’s most vulnerable citizen’s (children, sickly, and elderly) are part of responding to a disaster in progress. Supplies of food, water, and infrastructure (wells, rafts) are part of preparation. Changes in animal raising and cultivation patterns are additional food-security measures to lessen the impact of potential disasters.

Self-help groups in drought prone areas have also marshaled efforts against natural disaster. A CRS partner in Rajasthan, Gram Vikash Navyuvak Mandal Laporiya (GVNML), reports villages have shored up water harvesting structures and developed pastureland for animal fodder as measures against a failing monsoon. In the Diocese of Udaipur, CRS partner UDSS notes that self-help groups of Dongarbhil village have constructed check dams and routinely clear and clean waterways and wells. As a result, water levels and farm productivity have increased, allowing villagers to return to their cultivation of traditional crops, like corn, wheat, and lentils. In one watershed, self-help groups have been able to convince all villagers to refrain from new marriages for an
entire year. Weddings in this tribal area constitute a major expense, with high a premium placed on the availability of food and alcohol. Regulating this tradition is the village's way of building a surplus of cash to mitigate predicted drought.

As a relief agency, CRS has seen particular benefit to the self-help model. Working with local NGOs, and coordinating with a variety of government and international agencies, CRS made two relief distributions in the State of Orissa within a two-year period. When a major cyclone struck in 1999, it affected 19,000 coastal villages, leaving many families homeless. CRS made distributions using conventional relief inputs and methods of distribution. CRS and partners also experimented with distributions through 365 self-help groups. The performance of relief efforts through self-help groups was far superior to conventional methods, inspiring CRS-led formation of new groups and instruction in disaster preparedness. In 1999, when massive floods returned, CRS made all distributions through self-help groups. Local distribution costs dropped by 60%. Moreover, improved watershed structures and other mitigation measures, spearheaded by SHGs as disaster preparedness activities, lessened flood impact on crops, animals, food stores, and elderly family members.

Loan Elasticity

The new microfinance takes into account the seasons and rhythms of the natural village. Two CRS partners in Madhya Pradesh, an extremely poor and drought-affected area of India, report that groups prefer to meet and save on evenings related to the lunar cycle, during full and half moons. These natural markers are easy to remember. Banks are even known to tie repayments to seasonal signs. A local banker near the rural city of Banswara asks groups to repay their loans when the tree called the Flame of the Forest blooms, usually coinciding with the harvest of winter grains and vegetables. The self-help group model acknowledges the importance of sowing and harvesting in farm life, and that farm life is subject to the vagaries of
nature, which separates the new microfinance from the old. Whereas in many countries, the sectors of agriculture and microfinance duel, in India, they are inseparable strands of rural development.

Internal loan terms from self-help group funds vary widely. Some groups require payments to come due in three months. Others require members to remit interest only each month, with principal payable in balloon installments based on household cash flow. Flexibility from banks is also surprising. Banks in Uttar Pradesh have successfully issued "cash credits," or a line of credit to groups based on savings. Orissa, the Puri branch of the Bank of India, issues "top-off" loans, where groups have a two-year term, but can apply for more credit as their savings increases.

**But Does It Work?**

Do self-help groups offer the anticipated impact? Does linking them to banks increase prosperity? A recent study commissioned by NABARD of 560 households from 223 self-help groups in 11 states indicates an emphatic "yes" to both questions. According to the study, 37% of members linked to banks by self-help promoting institutions were marginal farmers and 34% of members were illiterate (Puhazhendi & Stayasai, 2000). CRS partners located in tribal areas (covering about 70,000 members) report that more than half the membership is landless due to losses to moneylenders.

According to the study, self-help groups linked to banks have produced benefits to members. Average assets increased by 73% from Rs. 6,843 (US$125) prior to joining an SHG to Rs. 11,793 (US$225) after joining an SHG in the study period, spanning an average of three years. Average annual income increased by 33% and savings tripled from Rs. 460 (US$9) to Rs. 1,444 (US$30).

As important as economic indicators are social measures of success. Before joining self-help groups, only 20% of members "exuded confidence," while after participation, 88% did so.
While only 29% of members felt they "could confidently face financial crisis" before joining their groups, 92% felt they could confidently do so after joining. Fifty-six percent of surveyed member households in self-help groups (older than three years) crossed the poverty line (Puhazhendi & Stayasai, 2000).

**Interesting Findings and Trends**

Recently, as more practitioners, bankers, donors, and scholars have soldiered forth into the world of self-help groups, many have reported findings worth noting. Here are just a few:

*Moneylender activities.* In Karnataka, CRS partner ODP reports that in four districts near Mysore, moneylender rates have dropped from 120% per year to 36% in villages where ODP groups operate.

*Groups helping others.* Many groups with members that include the poor in a village extend themselves to the very poorest. They do so in several ways. Groups in Jharkhand report that members save a handful of rice each day. At the end of the month, members sell the collective rice to their poorest neighbors for about half the price that they would sell it to market vendors.

In Orissa, several groups faced the problem of day laborers (the poorest of the poor and often members of scheduled castes) being unable to save the same amount as other group members in a village. Further, these poorer community members could not attend the same meetings as the better-off ones; meeting times were inconvenient. Self-help groups have helped the poorest women to form their own groups. In these new groups, members save as little as Rs. 5 per month. Leaders set meeting times when members can all meet, often early in the morning.

*Social Clustering.* With NGO support, groups cluster themselves as part of more powerful, village-level entities. Clustering, or the grouping of groups, is taking place so that groups can solve community problems and bring in more resources efficiently. Social clusters have worked to stem
murder (Madya Pradesh), to stop rape (Jharkhand), to improve schools (Kerala), to manage watershed and income generation projects (Rajasthan), and to reclaim land (Uttar Pradesh).

A Profile of the Old and New

Table 5 summarizes some of the major differences in approach between the new microfinance and the old.

Challenges Ahead

The new microfinance has enjoyed an auspicious beginning. But what lies ahead as self-help groups multiply and the bank linkage programs continue?

*Are NGOs a bottleneck to information?* A key role for NGOs is to bring information to groups about local opportunities: bank credit, skills training, and ways to participate in the village governance structure. A growing concern for CRS is that some partners may be withholding information that is inconvenient for them to share with the groups. For example, one CRS partner is still offering self-help groups credit from its own pool of loan funds. Groups are unaware that they can borrow at a lower interest rate from a local bank. The partner claims groups do not use banking services. In reality, groups know little about the service and what they do know comes from biased remarks delivered by the partner. This situation asks this question: to what extent should NGOs screen opportunities and information?

*Can members really leave their groups?* This is a second challenge. Most self-help groups evaluated by CRS do not make provisions in their bylaws for a member to exit the group, until a member actually wants to leave or needs to leave. Members must leave for a variety of reasons, with migration and marriage commonly cited. Groups make provisions for a member's exit on an as-needed basis. A lack of a clear means, discussed in advance, for a woman to leave a group makes withdrawal difficult. Women often report feeling shame when they do leave because they believe they are breaking the rules.
Table 5: Comparison of New and Old Microfinance

<table>
<thead>
<tr>
<th>Category</th>
<th>Old Microfinance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rules of Model</td>
<td>Intricate, explicit rules dictated and directed by MFI.</td>
</tr>
<tr>
<td>Institutional Thrust</td>
<td>Single actor providing both organizing and credit services.</td>
</tr>
<tr>
<td>Growth Strategy</td>
<td>Reliance on paid animators (field workers) to engage community members to participate in scheme</td>
</tr>
<tr>
<td>Locus of Sustainability</td>
<td>Self-sufficiency sought at institutional level; institution to cover all costs through internally generated income</td>
</tr>
<tr>
<td>Transparency of Options</td>
<td>MFIs tempted to withhold information concerning competitive local resources (e.g. lower interest loans)</td>
</tr>
<tr>
<td>Service Providers</td>
<td>MFIs provide group organizing functions, credit, and in some cases, savings and insurance (insurance often provided by third parties)</td>
</tr>
<tr>
<td>Financial Service Focus</td>
<td>Credit-led with savings services in some cases; credit minimum high in order to cover transaction costs of borrower</td>
</tr>
<tr>
<td>Credit Profile</td>
<td>Credit tailored to the needs of the financial institution for cost purposes; loan terms and repayment practices based on institutional viability; therefore rigid regarding regular payments of principal</td>
</tr>
<tr>
<td>Loan Purpose</td>
<td>Initial loans typically designated for income generating purposes</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>Calculated to cover costs of specialized institution plus institutional and investor need for return on investment; rates often ranging from 36% to 87% (CRS MFIs)</td>
</tr>
<tr>
<td>Depth of Outreach</td>
<td>High minimum loan amounts (at least $20 per member) preventing reaching the poorest; also, rigidity in repayment of principal excludes seasonal cash flow patterns of poorest</td>
</tr>
<tr>
<td>Drop Outs</td>
<td>CRS own data shows 11% lowest rate; some programs with 30%</td>
</tr>
<tr>
<td>Annual Investment per Client</td>
<td>Investment and opportunity costs high; in initial five years investment is as high as $300 per client, including operating subsidy plus loan capital</td>
</tr>
</tbody>
</table>
Table 4 Cont’d

New Microfinance

<table>
<thead>
<tr>
<th>Rules of Model</th>
<th>Simple rules made by groups.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional Thrust</td>
<td>Multiple actors providing organizing, savings, and credit services</td>
</tr>
<tr>
<td>Growth Strategy</td>
<td>Growth often resulting from “ripple effect”: groups forming new groups; local volunteers spreading information</td>
</tr>
<tr>
<td>Locus of Sustainability</td>
<td>Self-sufficiency sought at group level; group able to cover costs through members’ labor and internally generated cash</td>
</tr>
<tr>
<td>Transparency of Options</td>
<td>NGOs have no reason to hold back important information and options that speak to the best interests of groups and members</td>
</tr>
<tr>
<td>Service Providers</td>
<td>SHIPs provide group-organizing functions; groups and banks provide credit; third parties provide insurance</td>
</tr>
<tr>
<td>Financial Service Focus</td>
<td>Savings-led, based on the concept of thrift; credit minimum nil, as group bears costs</td>
</tr>
<tr>
<td>Credit Profile</td>
<td>Financial services flexible and based on capacity of each group member; terms often negotiated—even mid-term—to adjust to repayment capacity of borrower</td>
</tr>
<tr>
<td>Loan Purpose</td>
<td>Initial loans typically used for any purpose</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>Calculated by group to cover “hard costs” and varying according to group need for return on investment; group level rates often range 24%-60%; Bank rates 12-13%</td>
</tr>
<tr>
<td>Depth of Outreach</td>
<td>Low minimum loan amounts allow even the most risk-averse poor to participate; flexible repayment of principal (both at group and bank level) consider the variable cash flow of the poorest</td>
</tr>
<tr>
<td>Drop Outs</td>
<td>Less than 5% per year (undocumented officially; data drawn from CRS-partner reports)</td>
</tr>
<tr>
<td>Annual Investment per Client</td>
<td>Investment and opportunity costs low; in initial five years, investment is as low as nil (for self-replicating groups) and as high as $10 per year per client (for CRS/partner supported groups)</td>
</tr>
</tbody>
</table>
Is there confusion in the marketplace? Swarnajayanti Grameen Swarozgar Yojana (SGSY) is a government program administered through NABARD. Groups may access one-time subsidized loans to help with income generation and other purposes. Because NGOs and groups have difficulty differentiating between this program and the SHG/bank linkage program, two problems arise. First, groups often form for the sole purpose of receiving these one-time benefits. Groups formed for an instant benefit tend to break up over time. Second, these government programs have targets that managers feel pressured to meet. Members have reported feeling pressured to form groups for the purpose of receiving SGSY loans.

Are the poorest still overlooked? While very poor women can and do participate in the self-help movement and the SHG/Bank linkage program, we find that sometimes the poorest are still excluded. Exclusion presents serious concerns. Rigid and regular savings, a practice designed to achieve a balance of power within the group, may prevent the poorest villagers, with irregular cash flows, from participating. The following example, while possibly an exaggerated form of the problem, illustrates what can go wrong for the very poor. In eastern India, an NGO was encouraging groups to save Rs. 100 per month in order to build up their internal loan fund. While in of itself this may be good advice, the groups we interviewed reported that half their members had left early on, unable to keep up with the high savings rate.

A second reason that the poorest may feel excluded is the increasing loan size. As group funds build, loan amounts tend to grow. A group member may have little trouble managing a loan for a few hundred rupees to buy chickens. But a loan for a few thousand rupees to purchase pigs can be daunting, especially if hardship visits the household. CRS has noted members dropping out because they could not repay a loan, even though they enjoyed perfect loan repayment previously.

Can SHGs really do everything? NGOs and government initiatives often task self-help groups with multiple activities,
many of which reflect a larger social agenda, specific governmental targets or the mission of a particular NGO. The engine which allows a self-help group to sustain itself and provide a stream of benefits to members is finance—credit and savings. Distractions from core financial activities can undermine their quality and thus jeopardize not only the financial functions of a group, but its ability to enjoy long term social benefits.

Few studies show whether or not a group is better off in social performance if it concentrates on perfecting financial activities—leaving social good as an expected consequence—or whether, conversely, a social agenda serves to strengthen a group’s financial activities. A CRS partner in Darjeeling claims that its own lack of “social animation” in groups has led to members saving and lending, but little else. A partner in Karnataka asserts, as do its groups, that multiple social activities serve to strengthen core interest in economic functions. Yet, when and how do external agents introduce social elements? How much can a group take before it implodes? Various organizations are looking into this concern.

Conclusion

Why is the new microfinance the world’s best kept secret? Here is why: Western donors cannot take substantial credit for the success of this model, so why publicize it? Though many international donors, such as IFAD, DFID, GTZ, Misereor, and Ford Foundation have supported the new microfinance, the U.S. government has been missing in action. Sadly, for many followers of positive trends in microfinance in the United States, the SHG/bank linkage scheme will gain currency only when USAID blesses it as a “best practice.” That blessing will occur as experts realize that profitability in a microfinance institution, a best practice of the old microfinance, comes to a handful of players and that breaking even is an elusive goal and, if ever reached, is reached by virtue of having exacted huge subsidies in start-up costs and capital.
This essay argues for a return to our original intent in microfinance, that is to improve the lives of the very poor. The new microfinance is a reaffirmation of our original intent, armed with new knowledge about how to make our intent real.

The new microfinance is a wholesale departure from the old. It rejects an imported model of development in favor of an indigenous one. It understands that in the eyes of our poorest clients, the power of thrift exceeds the power of credit. It recognizes the totality of problems in rural communities and the diversity of solutions inherent in the self-help model. It places groups at the center of a wide sweep of activities and promotes microfinance as a means to sustain these activities, not as a goal unto itself. It builds on local NGO strengths and natural capacities and discards the costly notion of transforming grassroots organizations into financial institutions.

Best of all, the new microfinance acknowledges that development is messy. It makes no effort to reproduce the tidy formulas or the gloss of the old microfinance. The new microfinance is loose, uncontrolled, free ranging. It is human and intimate, simple, nimble. It celebrates the many expressions of group formation and the infinite, improvised experiences of group members. It looks to banks to provide banking services and to offer bankers a chance to enjoy an unbidden but gratifying social contribution. The new microfinance sees the division of labor as key to efficient programming and looks to a robust set of actors to play their appropriate roles. It honors in full measure the notion of stewardship, where subsidy, if wise, is good.

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The New Microfinance


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Ashrai
A Savings-Led Model for Fighting Poverty and Discrimination

by Brett Matthews
Dr. Ahsan Ali

Abstract: Ashrai is getting results with a savings-led model among minority peoples in northwest Bangladesh. These people are mostly landless and illiterate, and earn about $50 a year per person. They are a vital population segment that microfinance institutions in Bangladesh and elsewhere are unable to serve successfully. Ashrai began its field work ten years ago by replicating Grameen Bank, but rapidly learned from its clients that they needed savings at least as much as loans; flexible loan repayment schedules structured around seasonal cash flow, and an easing of the requirement that loans be for productive purposes. Ashrai takes an innovative approach based on intensive capacity building to help clients build small, informal financial intermediaries. Savings mobilization, institution-building, and education/literacy interventions work together to support the efforts of some of the world's poorest people to build a base of economic power and self-respect.

Introduction

Ashrai (pronounced, "ash roy," meaning "shelter" in Bengali) is an NGO working among ethno-linguistic minorities living in the Barind Tract in the northwest division of Rajshahi in Bangladesh. There are at least a million of these people (referred to as "Adivasis" in Bangladesh) in the region. They include groups with languages of Austro-Asiatic origin (the Santal, Munda, and Mahali) and Dravidian origin (Oraon and Paharia). As a group
they face substantial barriers to participation in local economic life, compounded by extremely high rates of illiteracy and landlessness.

Ashrai's model of savings-led microfinance is showing early signs of success, reducing the vulnerability of Adivasi clients to hunger and land loss, while supporting their efforts to stabilize their cash flow and build up family and community assets. The lessons learned from Ashrai's practice will be of value to practitioners working elsewhere among marginalized indigenous peoples and other very poor people.

Table 1. Growth of Ashrai's Village Samities

<table>
<thead>
<tr>
<th></th>
<th>June, 2002</th>
<th>December, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of (women)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>members</td>
<td>55,000</td>
<td>10,400</td>
</tr>
<tr>
<td>No. of savings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>societies (“samities”)</td>
<td>3,100</td>
<td>610</td>
</tr>
<tr>
<td>Savings</td>
<td>$863,000</td>
<td>$53,700</td>
</tr>
<tr>
<td>Loans</td>
<td>$792,700</td>
<td>$47,500</td>
</tr>
</tbody>
</table>

Source: Ashrai and Alamgir, 1997.
Note: Currency figures are translated from Bangladeshi taka at prevailing exchange rates. These were 57.0 taka = US$1.00 (June, 2002) and 42.5 taka = US$1.00 (Dec. 1996).

Ashrai

Founded in January, 1991, Ashrai is dedicated to improving the standard of living of the minority peoples it works with and to integrating them into the mainstream of economic development in Bangladesh. Ashrai spent five years testing and refining its operating methodology. Once it had established a solid foundation, it grew quickly, as Table 1 testifies.

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Volume 4 Number 2
Ashrai: A Savings-Led Model

Starting in the division's districts of Rajshahi, Naogaon, and Nababganj, Ashrai is now moving into Jaypurhat and Dinajpur.

Fighting Adivasi Poverty

The founder and executive director of Ashrai is Dr. Ahsan Ali. Dr. Ali completed his Ph.D. in anthropology among the Santals—the largest ethno-linguistic minority in the region—before launching Ashrai. The poverty he documented among the Santals was extreme, even by the standards of Bangladesh, and was perpetuated by several factors (Ali, 1991).

The Santals speak an ancient language (Santali) which is unrelated to Bengali (the dominant language of the region) as well as to other local tongues. They are scattered on both sides of the Indian border and still retain their traditional priestly and life cycle institutions, whether, they have adopted other ways from their neighbours. They have a very uneasy relationship with the Muslim majority.

A later study by Alamgir (1997) based on a sample of 179 women clients of Ashrai found that:
- 5% are literate, while a further 29% know how to write their names
- 39% belong to landless families; average holdings of other families are 0.47 acres
- 63% live in houses with mud walls and thatched roofs; average houses have 1.7 rooms
- 67% have total assets (including real property) worth less than $900

Alamgir reported average income at about $50 per year per person, compared to an average income of $324 for Bangladesh (World Bank, 2002). Because they are landless, most Adivasis make their living as day labourers on their neighbours' farms. Agricultural labour rates in Rajshahi during the three month harvest season are about $0.70 a day plus one and a half days' supply of rice (for men), and $0.53 a day plus one and half days of rice for women. Off-harvest employment is sporadic and
labour rates fall to about $0.44 a day (men) and $0.35 a day (women), without rice.¹

There is a well-documented dynamic of indebtedness and land loss in this region that has had tragic consequences for the Adivasis (see for example BRAC, 1983; Alamgir, 1997; Islam, 2002). A natural disaster, like a drought or a flood, will cause the rice crop to fail, and to avoid starvation, a family will borrow. Credit from local moneylenders carries interest rates starting around the equivalent of 100% per annum (rates vary widely and have frequently been documented at above 1,000%). Adivasis also sell their labour at a discount of up to 50%, two to three months before the harvest.

Land loss often results from the manipulation of public records or bribery of judges and municipal officials. This process is simplified when the victim’s family is illiterate and belongs to a disliked minority group.

In a well publicized incident in 2000 in Naogaon district, the heartland of Ashrai’s work, local leaders forged documents and harassed a group of 19 Santal families for nearly two years in order to scare them from their land. When the families refused to move, the leaders hired thugs one night who burned down the Santal homes and ambushed people as they escaped the inferno. One was killed; many more were critically injured. The police took four and half hours to arrive on the scene (Daily Star, August 21, 2000). The Oraons, who have adopted many Hindu ways, face the added burden of government legislation that strips Hindus of legal rights in the event of land-loss.¹

Even in the absence of deceit or outright crime, the weight of a borrower’s debt can exceed the capacity of the family’s ability to repay, or another crop failure can compound the first. In either case, the likely result is land loss.

These dire conditions have led to a breakdown in Adivasi authority structures. Ahsan Ali’s doctoral research among the Santals revealed communities in disarray. Unable to protect their people from discrimination and poverty, the traditional
committees of male elders had lost much of their decision-making authority.

By the early 1990s, these committees had mostly been reduced to one active member—the village headman. This official presides over ceremonies and rituals, but has lost real authority in the political and economic spheres.

Under these conditions, the obstacles to a successful savings-led microfinance project are formidable. The evidence suggests that the participation rate among Adivasis in major credit-led models like Grameen, BRAC, and ASA is very low, in spite of the fact that these NGOs are active throughout Rajshahi District.

Nevertheless, as a direct result of Ashrai’s program,
• 58% of members have been able to improve the education of their children
• 60% experienced improvement in personal and family nutrition
• 41% gained increased access to medicine
• 80% experienced improvement in opportunities to work for extra income (Alamgir, 1997, pp. 47–48; 61–63)

Ashrai’s Strategy

Ashrai’s strategy for achieving its goals is to support the efforts of Adivasi women and their communities to accumulate their own independent pool of capital.

Implementation of the strategy involves four phases:
• Investing in human capital and leadership development
• Incubating savings samities as a tangible first step to rebuilding the economic power of its client populations
• Promoting a multi-tiered organizational structure that reinvents and invigorates traditional minority institutions
• Withdrawing from an active support role as the different elements of the network achieve independence

The first three phases are self-reinforcing. The savings samities must gradually accumulate the capital that the minority populations need to achieve economic emancipation. In
Ashrai’s strategy, they are like a truck and forklift: they do the heavy lifting and the long-distance hauling. But they are dependent on prior investments in training to work effectively and dependent on later investments in technical support and organization institution-building to keep their goals aligned with those of other groups beyond their village and to achieve permanent independence from Ashrai.

Ashrai’s strategy prepares the samities to become self-reliant and sustainable, both financially and managerially. Those demonstrating consistent progress in saving and sound management are given the opportunity to borrow from Ashrai for on lending to their members. Ashrai has gradually and prudently increased lending to the samities from 77% of internal savings (Dec. 1996) to 104% (June, 2002).

Nevertheless, the very real successes of the savings mobilization program, combined with the emergence of samities that were able to manage their affairs, offered Ashrai an early opportunity to revitalize and to reinvent the traditional village committees.

As part of its incubation strategy, Ashrai has also invested in developing “tribal development councils” in each union (a union is an administrative district with about 20 villages). These elected councils work to rebuild Adivasi identity and resolve inter-village problems. Led by a headman selected through lineage, the councils also include the three leaders of the local women’s samity (president, secretary, and cashier).

Evidence on Ashrai’s Strategy
Initially Ashrai adopted the Grameen Bank methodology among the Adivasis, but in response to client demand in rapidly adopted an approach that did not require fixed weekly payments or dictate the loan purpose. The Grameen model did not meet the highly seasonal cash flow cycle of Ashrai’s clients, or their primary borrowing needs, which were often to prevent hunger or avoid indebtedness to a moneylender.
Table 2: Progress Towards Ashrai's Exit Strategy

<table>
<thead>
<tr>
<th></th>
<th>June, 2002</th>
<th>December, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of samities</td>
<td>3,100</td>
<td>610</td>
</tr>
<tr>
<td>No. of village councils</td>
<td>3,100</td>
<td>259</td>
</tr>
<tr>
<td>Groups that have hired book-keepers</td>
<td>1,585</td>
<td>0</td>
</tr>
<tr>
<td>No. of regional &quot;tribal development&quot; councils</td>
<td>88</td>
<td>20</td>
</tr>
</tbody>
</table>

Sources: Ashrai, 2002, and Alamgir, 1997

By eschewing restrictions on loan purpose—difficult and expensive to enforce in any case—Ashrai has provided the Adivasis with the flexibility to stabilize their cash flow before starting to invest in microenterprises. The early evidence suggests that they do invest once their family position is more secure. Srinivasan et al. tracked loan use in one samity from 1996 to 1998 and found a strong shift from food purchase to productive investment (Srinivasan et al., 1999, pp. 10-11). Since beginning to track loan use in 2000, Ashrai has found that the percent of loans used to buy food has dropped to 12% from 21%, while those used to invest in agricultural tools, seeds, and other inputs have risen to 55% from 41%.

Embedded in samity membership is another important flexibility—the option not to borrow. Membership has been built primarily around a willingness to save and it has been made clear from the beginning to all members that external loans are not a standard part of the arrangement. As of June 30, 2002, there were 16,000 members who had no loans at all.

At the heart of Ashrai's strategy is the successful incubation of self-reliant savings samities. Results in the field are encouraging.

Ashrai targets an incubation cycle of five years from the formation of each samity to self-reliance. It has not yet achieved this target. The problem is not interest rates, which
are set by the members, generally between 24–36%, with operational profits on lending returned to members in the form of dividends every six months. The problem seems to be the sheer number of challenges in building savings-based financial intermediaries in villages where 95% of the people are illiterate.

However, Ashrai has already demonstrated a cycle time of about 6 years. Given that, there is no reason to believe that cycle time—and the current cost of $18 per member over the incubation period—cannot be reduced in the future as Ashrai becomes more efficient through experience and scale (see Table 3).

Financial service delivery to the groups is centred on the work of the Field Officers and the Area Officers. In total there were 186 of these staff—mostly Adivasi males—serving 55,000 women, organized in 3,100 groups in June 2002. The average Field Officer has 10 years of education and earns $32 a month, plus benefits.

Until 2000, Ashrai's staff kept the books for most of the samities. However, training for the groups emphasizes that support is time-limited. In 2000, a prior investment by the NGO in "non-formal primary education" began to yield dividends. By mid-2002, 1,585 groups had found bookkeepers they could trust and were paying them for their services. Private bookkeepers—usually women with 5–8 years of education and often students—receive between $0.55 to $0.85 a month to manage a group's accounts. This work takes about 10 hours.

It would not currently be possible for the groups to pay for the cost of an Ashrai Field Officer. However, there is a strong positive correlation between the asset-base of the samity and the compensation it pays to the bookkeeper, meaning that as the capital pools of the groups expand, they increase their compensation. Most bookkeepers serve only one samity, but about 100 serve two or more.

It is difficult to determine exactly how many samities are financially self-reliant at present, because of Ashrai's role as an integrated services NGO. Even "self-reliant" groups are typically continuing to receive regular visits from Ashrai's staff for
Table 3. Incubation Cycle of a Samity

<table>
<thead>
<tr>
<th>Stage</th>
<th>Cost</th>
<th>No. of months</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advance planning, logistics etc.</td>
<td>$10</td>
<td></td>
</tr>
<tr>
<td>Survey and preparation in village</td>
<td>$3</td>
<td></td>
</tr>
<tr>
<td>Forming the samity</td>
<td>$37</td>
<td></td>
</tr>
<tr>
<td><strong>Development</strong></td>
<td></td>
<td>71</td>
</tr>
<tr>
<td>Train management, bookkeeper and members</td>
<td>$13</td>
<td></td>
</tr>
<tr>
<td>Provide audits</td>
<td>$20</td>
<td></td>
</tr>
<tr>
<td>Provide book-keeping</td>
<td>$38</td>
<td></td>
</tr>
<tr>
<td>Provide direct management</td>
<td>$81</td>
<td></td>
</tr>
<tr>
<td>Leadership development</td>
<td>$133</td>
<td></td>
</tr>
<tr>
<td><strong>Phase-Out</strong></td>
<td></td>
<td>N/A</td>
</tr>
<tr>
<td>Groups are self-managed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Groups pay for their own bookkeeping</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Groups borrow at market rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audits are provided at market rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>$346</td>
</tr>
<tr>
<td><strong>Cost/member during the incubation</strong></td>
<td></td>
<td>72</td>
</tr>
<tr>
<td>period</td>
<td></td>
<td>$18</td>
</tr>
</tbody>
</table>

Source: Ashrai accounts.
Notes: Overhead costs, based on Ashrai's most current audit, are included in each line item. Ashrai currently loses money on the loans it issues to samities. These losses are not reflected here as a cost because Ashrai's loans are priced at market—that is, the losses reflect operational inefficiencies.

non-financial reasons, such as literacy and health training, and workshops on income generation and other matters. In addition, Ashrai continues to play a role in resolving disputes that the groups' executive committees are unable to resolve. In this setting, "self-reliant" groups are those that:
successfully intermediate between their own savers and borrowers at a profit
more generally manage their financial affairs without assistance
hire, and pay for, their own book-keeper
pay for other services such as audits as needed

About 500 of the older samities currently meet all these criteria except the last. While the final point is important, it is maintained here that groups willing to take on the large cost of hiring a bookkeeper would not object to paying the smaller cost of an audit, should Ashrai stop delivering this service at no cost.

The development of the regional councils has been a much more challenging process. The councils were expected to gradually take over Ashrai’s incubation role. With this responsibility would come an ongoing role of delivering the typical services of a second level microfinance institution, such as training the staff of primary level samities in bookkeeping and governance, providing technical assistance, collecting and aggregating data, auditing and managing/on-lending reserves.

However, the financial management capacity required to incubate the regional councils is more typical of formal MFI than of an NGO like Ashrai. Currently, primary financial management measurements of sustainability, service efficiency, and portfolio quality are tracked sporadically at Ashrai or not at all. It is not clear how Ashrai can transfer skills it does not possess (M-CRIL, 2000; Choudhury, 2001).

But Ashrai has also learned from its success in serving Adivasis and is testing its approach with very poor non-Adivasi populations, who now make up 10% of their clientelle, up from virtually none three years ago. The NGO has reached a critical point in its institutional development: will it build an MFI or not? As BRAC and Grameen increasingly focus on “ultra-poor” and other hard-to-serve markets, and as new players like the Norwegian Strome Memorial Foundation become
interested in reaching the Adivasis with microfinance, Ashrai cannot postpone this decision any longer.

There is currently a debate among Ashrai's stakeholders about the right role for the NGO after exit.

One alternative would be for Ashrai to spin off its financial services division as a separately registered MFI, managing the reserve deposits of regional councils and providing them with loans as required. The NGO would then take a new shape, specializing in human resource development among Adivasis.

Another alternative might be to help the regional councils link to the formal financial sector, somewhat along the lines of the self-help group/NGO/bank linkages currently being promoted by NABARD in India. Ashrai would continue to function as an NGO specializing in Adivasi issues and deepen its capacity to catalyze financial sanities and regional councils among other ethnic minorities and extremely poor rural people.

**Lessons for Practitioners**

Ashrai is a well-managed organization with a 10 year track record of meeting and often exceeding planned goals. It is an innovative organization that has adapted its products and processes over time to a distinctive client base. A flexible, long-term relationship with a single donor (the Swiss Agency for Development & Cooperation) has been a valuable asset, providing freedom to learn in the field. A summary of the lessons it has learned to date in one of the world's toughest laboratories is below.

**Savings**

Ashrai is catalyzing a savings-led accumulation process that could potentially lead to economic self-reliance among highly vulnerable, illiterate, indigenous peoples who earn $50 a year. Its work highlights an emerging recognition that savings balances are vital financial assets that reduce personal and family
risk, in contrast to a loan, which increases income at the cost of increasing personal and family risk. It would be difficult to point to stronger evidence that the poor can and will save than in the Rajshahi Division of Bangladesh.

**Internal Control**
Retail bank managers know that the main line of defence against staff who divert client funds for their own use is the personal account statement—or a generation ago, the personal passbook. But that line of defense depends on client literacy. If depositors do not recognize the line items in their passbooks, how will they know if the deposit is short? And how will the manager find out that the teller is cheating?

One of Ashrai’s most effective field innovations is its bookkeeping system. This system features a one-page summary of all key data, including cash, bank balances, and profit, and can be utilized by anyone with very basic literacy skills. Members are taught to be able to recognize simple numbers, and are taught to check the samity records against their own at every meeting.

**Institutions**
Ashrai is showing that the samity is an institutional tool that can reach more deeply into the ranks of the poor than the traditional top-down, branch-based MFI focused on wide outreach and a permanent model of direct service delivery. The samity supports education while keeping opportunities for fraud to a minimum. Over a reasonable period of time, it can become self-reliant. The incubation process is essentially one of starting up a self-help group, with both financial and social goals, and gradually transforming it into a kind of “accumulating savings and credit association” (ASCA) of a kind that is quite common in South Asia, though primarily in urban areas (see Rutherford, 2000, for a recent categorization).

Ashrai can learn from the circumstances of ASCAs, which often hire private entrepreneurs to provide management and audit services. Through Ashrai’s, work the value of bookkeeping
skills has probably become evident to many Adivasi communities by now. The next step could be to nurture an open market for Ashrai “certified” bookkeepers—whether or not they are backed by an explicit savings guarantee from the NGO. In principle it should also be possible to develop an audit market, but this is undoubtedly a longer term project in such a poor area.

Microcredit
Ashrai's experience raises questions about the value of microcredit programs that inject external funds into savings-led ASCA-type groups. External funds risk confusing members about the purpose of their membership, and requires NGOs to take on financial intermediation functions to which they may not be well suited. NGOs wishing to learn from Ashrai’s experience would do well to subject microcredit plans to a very careful cost/benefit analysis before launching them.

Notes
1. There are debates about the Adivasi population size, and no reliable statistics are available. The government estimates the population in the Rajshahi Division at about 200,000 people, but Ashrai has so far mobilized 50,000 Adivasis in the district. Each member represents a family averaging 5 people, and Ashrai has yet to start working in over half the territory of the division.

2. While there is a general acknowledgement among observers that the Adivasis as a group are poorer than their rural neighbours, there have been few studies that clearly or reliably quantify the disparity. Alamgir made this estimate based on interviews with a sample of 179 Ashrai clients in his 1997 study cited earlier.

3. Taka 40/30 a day in harvest season and 25/20 at other times. Interview with Dewan Alamgir, October 24, 2002.

4. NGOs in Bangladesh contend (Special rapporteur, 2000) that The Vested Properties Act (1972) has deprived Hindus and Adivasis with Hindu roots of legal recourse related to the seizure of over two million acres of land. This contention is backed up by the experience of Ashrai, particularly in Naogaon district.

6. Poor and illiterate people can and do run rotating savings and credit associations (ROSCAs), but these are usually temporary in nature and never carry surplus cash balances, thus avoiding the need for any sort of bookkeeping. For financial societies that aim for permanence or intend to carry cash balances beyond the end of a meeting, a precondition of success is the participation of several literate and numerate people—not only to watch the books, but also to watch each other. This is why ASCAs tend to be more common in urban areas. See Rutherford’s (2000) classification of informal financial arrangements among poor people, especially Chapter 2 on ASCAs.

References


Book Review

*Inner-City Entrepreneurship Development: The Microcredit Challenge.*

By Nitin Bhatt

By Jerry Black

*Inner-City Entrepreneurship Development: The Microcredit Challenge,* by Nitin Bhatt has several themes, but is primarily a critique of the U.S. microenterprise development industry. Mr. Bhatt's book discusses the performance of a few microcredit programs in California, and compares the domestic microenterprise field (as reflected in the performance of four peer lending programs) to international microfinance. The book has two methodological flaws and one noticeable strength. It draws conclusions about the domestic microenterprise field based on a small amount of data on the performance of a few non-representative programs in California; and it draws inappropriate comparisons between two different things—the U.S. microenterprise development industry and large microfinance institutions in developing countries. Its strength, in chapter four, is an analysis of factors that correlate with positive loan performance for peer lending programs. This reviewer is dismayed by Bhatt's analysis of the performance of the U.S. field, particularly since the book is so clearly targeted and marketed to funders and policy makers. The book does not stand up to much scrutiny, despite the extensive list
of articles referenced and marshalled, pawn-like, to buttress its thin foundation.

Its title notwithstanding, *Inner City* has little to say about inner cities, or entrepreneurship; it is about microcredit programs, and is based on a study of four agencies. The sample size does not deter Mr. Bhatt from forging ahead with a formidable agenda. Secure in an appreciation for the “rich diversity of experiences in microenterprise development” (p. 18) achieved through a study of four programs modeled after overseas peer lending programs, Bhatt presents to “bankers, non-profit managers, foundation personnel, and policy makers” his answers to important questions: “What kinds of operational challenges do microcredit institutions face in the United States? What is their loan repayment performance? What factors impact their operational and financial viability? To what extent can microcredit models work in the United States?” (p. xii). These are, of course, important questions for the diverse field of domestic microenterprise development. It is rather surprising that Mr. Bhatt chooses to answer them and to represent to funders and policy makers the “systemic roots of the problems that confront microfinance institutions” (p. xii) based on an examination of four small peer lending programs in California.

Sustainability of microcredit services preoccupies Bhatt: “Programs that do not move toward making operational self-sufficiency a priority remain dependent on subsidies to keep the doors open. Although subsidies are not ‘bad’ per se, evidence from the U.S. microcredit programs suggests that once the funding dries up, organizations fold, as do sources of financing for the community” (p. 15). Bhatt is certainly correct to point to the important challenge facing most U.S. microenterprise development programs to achieve operational self-sufficiency. Practitioners in the U.S. field are of course
well aware of the importance of working toward higher levels of self-sufficiency, and in fact some have made significant strides along this front. For example, from 1999 to 2000 the average operational self-sufficiency of a group of thirty microenterprise programs participating in the Aspen Institute’s MicroTest project rose from 23% to 35%, and the most operationally self-sufficient programs in MicroTest (the top 20% of a group of 51 programs) are all achieving at least 50% operational self-sufficiency. A handful of programs have achieved over 70% self-sufficiency, as well.¹

But most programs do not pursue self-sufficiency above all else, or at the expense of maintaining a sense of mission. Most observers of this field acknowledge that some level of donor support will continue to remain critical to the ability of programs in the U.S. to offer their services, especially to the more disadvantaged who seek information through training and technical assistance, and are generally less able to pay fees that would cover the full cost a program incurs to deliver a high quality training course. The fact that microenterprise development services in the U.S. center as much around business development training and consulting as around the delivery of microcredit is an important distinction to make, and one that the reader of Inner-City unfamiliar with the domestic microenterprise field would be likely to miss. A narrow focus on microcredit in the U.S., in many ways, misses the point if it disregards the accompanying training and technical assistance that typically accompanies those loans, and belies a major distinction between the way U.S. programs deliver microcredit and international microfinance.

Bhatt argues that attempts to measure the net social and economic impact of microcredit on borrowers and clients has not produced solid evidence; “most studies... have failed to provide evidence that provisions of credit, training, and t.a. are good uses of scarce public resources” (p. 28). This observation is debatable. The U.S. microenterprise industry contains many very efficient programs that show quite low costs on a per
client or per borrower basis; some programs make very good use of scarce public dollars. Several studies have shown generally positive outcomes associated with microenterprise services, including strong business survival rates, increases in household income and assets, and decreases in reliance on welfare benefits. For a good overview of different evaluations of microenterprise development programs in the U.S., see pages 25 through 43 of Else and Gallagher's 2000 overview of this field for the International Labour Office.2

With respect to evaluating microcredit activities, Bhatt proposes a new theoretical evaluative framework in chapter two, based on "New Institutional Economics." An odd discussion of "constraints," "contexts," and "conditions" (all concerned with different aspects of microcredit, and drawing on a wide variety of academic literature) ensues which eventually leads Bhatt to compare the "safety net" (such as it is) in the U.S. to more vulnerable conditions of overseas borrowers who, he argues, lack the U.S. welfare state, and consequently face a weaker set of incentives to run successful businesses (pp. 33-38). Somehow all of this relates to designing programs in the inner-cities of America. Yet if, as Bhatt maintains, it is important to consider each area's unique socioeconomic context when designing and delivering appropriate services to a community, then why does Bhatt spend so much time—in a book about U.S. inner cities—discussing developing countries? Where is the analysis of 'inner-city realities' the reader keeps waiting for?

The book's limited discussion of poor people in inner cities proceeds through a series of generalizations: "the lack of relevant business experience, for instance, of welfare recipients, coupled with their usually limited education and skills, severely restricts their entrepreneurial capacity and ability to make the right business decisions." (p. 39). No data are presented to back up this statement. In a section about 'sanctioning mechanisms' to deter loan defaults, Bhatt makes this observation: "But communities in the United States, especially
those within the inner cities, seldom rely on social cohesiveness or reputational assets for conducting day-to-day business. The fear of community sanctions is often insufficient to deter default among borrowers under such circumstances. (p. 41)" Again, no studies are cited.

*Inner-City* is an imbalanced assessment of the state of microenterprise lending in the U.S. An example of Bhatt's footloose methodology is illustrated in the following passage concerning the challenges microcredit programs have in making large numbers of loans, and exercising sound portfolio management, to achieve higher levels of sustainability:

Among the 16 California microcredit programs surveyed...the average number of loans disbursed was 7 per year, with 20 being the maximum....If these numbers are representative of programs in the United States, and assuming that there are 400...programs active in the country, the entire microcredit industry in the country is serving [only] around 10,000 microentrepreneurs per year. (p. 117)

But do the few peer lending programs studied in California represent the average performance of all domestic microcredit programs? The answer is no. According to data collected by the Aspen Institute, the average number of microenterprise loans disbursed by a set of 176 microlenders in 2000, was 41. The average number of microloans disbursed by a set of 46 programs participating in the annual MicroTest performance assessment project that same year, was 76. For 26 of the MicroTest-participating lenders who describe themselves as being more "credit-led" than "training-led," this average is 112 microloans disbursed (and a maximum of over 700—far from the 20 uncovered in Bhatt’s research) for an average total of $620,957 in microenterprise loans disbursed.

What about portfolio management? Bhatt laments the tendency he observed in the U.S. for microcredit programs to fail "to communicate the need for financial discipline among borrowers....and [to act] for the most part as grantmaking bodies
rather than lending agencies. (p. 115) But is such a dire assessment justified? The data supporting Bhatt’s critique of portfolio management is minimal: one program’s portfolio-at-risk and annual loan loss data is shown in a time series table (p. 126). Again, it is useful to look to other sources of data for a more balanced and fair description of the general quality of portfolio management among domestic microcredit programs.

For a group of 43 microcredit programs (which includes a handful of peer lenders) who reported portfolio quality indicators to MicroTest in 2000, their average and median loan loss rates were 5 percent. There is some variation in average loan loss rates based on geography, with urban programs tending to experience less loan loss than rural programs (medians of 2% and 7%, respectively). Further, loan loss rates on average remained stable at 5% from 1999 to 2000 for a group of 30 microcredit programs who reported this information in both years to MicroTest. Finally, there are a good number of microcredit programs in the U.S. who exhibit even sounder portfolio quality figures: 17 of 43 programs in MicroTest had loan loss rates in 2000 below 2.2%. It is simply wrong to attempt to extrapolate the negative findings from this small sample in Inner-City to the broader U.S. microenterprise field.

Since much of Inner-City rests on a shaky foundation of data, it is reasonable to make the case that this book is better ignored than digested. However, some of Bhatt’s analysis and insights shed light on the factors that lead to effective loan repayment rates for programs that utilize a group-lending methodology. Simply, Bhatt’s analysis of repayment performance for such programs identifies a few factors that correlate to positive loan performance: educational attainment of the borrower, proximity to the lending program (which facilitates portfolio monitoring), low transaction costs (such as when a borrower does not have to wait long to receive the loan, once approved), and the presence of clear sanctions to discourage default. Bhatt’s presentation in chapter four of the statistical analysis underpinning these findings is clear and logical. Even
so, the findings only apply to peer lending programs, and as such have a somewhat limited audience in the U.S. where individual lending programs are more widespread. While this reader can not recommend much of *Inner-City*, chapter four, insofar as it applies to peer lenders, is a useful contribution to the microenterprise development field.

This review represents the views and opinions of the author only, and not the opinion of the Aspen Institute. The author of this review manages MicroTest, a four year effort to document and improve the performance of the domestic microenterprise development field through the promotion of performance measures defined and embraced by a large group of microenterprise development practitioners. For more on MicroTest, see www.fieldus.org.

**Notes**

3. For Good Measure. p.10
4. Ibid. p. 10.
5. Ibid. p. 25.
6. Ibid. p. 32.
7. Ibid. p. 33.
8. Ibid. p. 34.
9. Ibid. p. 34.
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