

# Case Study on Best Practices Aimed at Popularizing Micro-Financing



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Economic Commission for Africa



**Economic Commission  
for Africa**



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**Case Study on Best Practices  
Aimed at Popularizing  
Micro-Financing**

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# I. INTRODUCTION

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## A. Background and justification

1. During the last two decades, Micro Finance Institutions (MFIs) in selected African, Asian and Latin American countries have been providing valuable financial services to poor clients who do not have access to formal financial resources. The number of MFIs providing credit-based services to the poor has increased from a mere handful in the early 1970s to several hundreds by the mid-1990s. If one adds the social development plans of many non-government organizations that integrate credit for the poor into their programmes, the number of MFI/ Ps (programmes) increases into thousands. The credit facilities provided by Grameen Bank (GB), Association for Rural Advancement (ASA), Bangladesh Rural Advancement Committee (BRAC) and Self-Employed Women's Association (SEWA) have also grown size and sophistication in their lending outreach.

2. The practice of micro-finance for the poor has evolved from a credit base, expanding into a range of other financial services that poor people need to pull themselves out of poverty and into the mainstream of development. The MFIs have gone beyond credit and provide savings. A few offer other financial services, such as various forms of insurance and family budgeting services. In a similar vein, the range of lending products on offer to poor people has expanded. Likewise the number of clients that have graduated beyond the poverty line, but continue to be borrowers, numbers in the millions across Asia. The importance of micro-finance for the alleviation of poverty is widely recognized by international organizations and development scholars. Access of the poor to financial services is believed to enhance their opportunities for economic development, although opinions differ as to the exact transmission mechanisms on the household or micro-economic level.

3. In many African countries, low income groups represent the majority of micro entrepreneurs, including informal enterprises. However, these micro enterprises in general face a wide variety of constraints that limit their productivity and growth. The latter range from limited access to financial services, to limited technical skills and knowledge, to regulatory policy and institutional constraints. This limitation in productivity reduces their contribution to countries' GNP. The formal banking system's failure to grant loans has not prevented small-scale business from mushrooming and expanding their sphere of influence. The survival instinct is high and has favored the development of the so-called "informal" sector. In support of the above, poverty-oriented banking is gaining wide recognition as a poverty alleviation strategy. These facilities focus on savings mobilization and provision of credit to the very poor. This is also seen as a way of increasing incomes and generating jobs and employment. Some actors; NGOs, Government and bilateral and multilateral donors have launched initiatives to address the problem of limited access to productive resources.

4. Also a consensus has grown on the gap between formal finance institutions and the low-income majority, which is now interpreted generally as a problem of transaction costs and institutional development. Again, opinions differ as to the best strategies for finance-institutional development, and the extent of the trade-offs between financial viability, outreach among the poor and the impact of financial services on social and economic development. Thus, any increase in the understanding and appreciation of the variety of uses to which micro-finance has been applied, through case studies on "Best practices" would:

- (i) stimulate response of the African financial institutions to the increasing demand for small loans;

- (ii) reinforce the need for the development of mechanisms for promoting micro-financing systems as viable sources for funding small-scale grassroots enterprises;
- (iii) facilitate access of the poor to productive resources;
- (iv) open up credit facilities to the rural population and rural development;
- (v) create awareness on the role of micro-financing to engage new entrants into the job market in business development;
- (vi) disseminate policies, strategies and practices which have been proven to be successful in fostering micro-credit; and
- (vii) articulate mechanisms for the active involvement of formal financial institutions in the provision of micro-financing services.

5. This desk study is for micro-entrepreneurs, NGOs involved in sponsoring micro-financing activities, researchers interested in micro-financing in Africa and Asia, government agencies dealing with micro-enterprises and their financing problems, banks who have shown little interest in supporting micro and small enterprises. They may be inspired and change their positions once they realize that banks elsewhere are involved in micro-financing with some success. The study presents the micro-financing activities in formal and semi-formal sectors in the following countries: Cameroon, République Centrafricaine, Bangladesh, India, Costa Rica, Nicaragua and Honduras. In selecting these countries, we are guided by the criteria of identifying micro-financing institutions with established records. The two institutions covered in Cameroon were cited as success stories by the World Bank. So, it was felt that including them in the study and sharing their experiences would be useful. Although one of the serious problems of extending credit to micro and small enterprises had to do with lack of interest in the scheme, the Central American experiences have been found to be significant. Some banks are taking the initiative to provide funding to micro-enterprises through groupings such as credit unions, village banks and cooperatives; we thought including the Central American cases would provide useful insight.

6. The study gives an overview of the importance of the micro-financing segment of the financial service industry before going into its typology. Then, after a thorough analysis of the micro-financing activities in the selected countries, the study builds on and discusses the major constraints of micro-financing, applicability of the Grameen Bank experience to some countries and the lessons learnt.

## **B. Overview of the importance of micro-financing**

7. There was a growing awareness that formal institutions, including public development banks, could not resolve the problems of access to financial services for the majority of the population. The public development banks were severely scrutinized and as they were often unprofitable they were subjected to severe restructuring plans. Thus, almost all the Development Banks in developing countries collapsed, their failure was attributed to political manipulation, dependence on subsidized funding, a lack of innovative capacity to develop financial technologies and instruments, and a heavy burden of bureaucracy. This was also the case in West and Central Africa. In Costa Rica the state banks lost their monopoly on deposit mobilization, that they enjoyed since the 1948 nationalization of the banking system. In Nicaragua the agricultural development bank was finally closed down in 1998, after several attempts for restructuring. And in Honduras the agricultural development bank has been virtually paralyzed, since in 1992 its foreclosure was openly discussed as an option.

8. Starting in the 1990s, a wave of financial reform led to significant changes in the structure of the financial sector. In all Central American countries, the laws of the Central Bank, private banks and supervisory institutions were changed. The mandate of the central banks was limited to the stabilization of the internal and external value of the currency, for which it received a higher degree of autonomy from politics. Reserve requirements were reduced and limited to the dimensions necessary for prudential regulation and thus were virtually excluded as instruments for macro-monetary management. Special discount facilities were taken out of the authority of the Central Banks and into the administration of autonomous APEX institutions. And the supervision and regulation of the banking system was delegated to autonomous Supervisory Boards.

9. Specifically for the micro-finance sector, the macro-economic situation and the financial reforms brought several important changes. First of all, the monetary contraction combined with a shift from public to private investments, and from public banking to private banking, led to changes in the credit portfolios. In some Central American countries, private banks restricted the access to credit to their elite clientele and abandoned the middle class segment that was marginally profitable for them. The public development banks did not any more have the capacity to lend to "special outreach" groups like land reform co-operatives, or small firms and farms. The consequence was that significant groups of the population that had previously had access to financial services lost that position.

10. With the decline of public development banks as sources of credit, NGOs that had accumulated some experience with micro-credit, claimed that they should be permitted to substitute the role of public development banking. This claim was expressed most clearly in Nicaragua, where a forum of civil organisations developed a dialogue with the government on several aspects of socio-economic policy. But also in the other countries the NGOs started to co-ordinate efforts for their recognition as MFIs with a public interest. The supervisory institutions interested in becoming acquainted with non-bank institutions that provide services to the rural and urban poor also started to grow. As the MFIs were increasingly eager to develop deposit services as a means of funding, they were becoming more relevant counterparts for the superintendents. Lately there are concrete efforts by Governments to develop adapted supervision and regulation procedures for MFIs, such as eligibility criteria to qualify for the regulatory supervision and prudential norms on capital adequacy and loan loss provisions. Also there are efforts to agree on common benchmarking systems, both from private initiatives of the MFI sector itself, as well as from public APEX institutions, (example in Gambia as well as FINSA-FONAPROVI Honduras).

11. A fundamental problem to the creation of adapted supervision standards for NGOs is their special status. Most of the NGOs have been legally founded through special government decrees, as associations or foundations, with an inherently ambiguous structure of ownership and capital. Their not-for-profit character may exist as an official statement in their charter, but their field of operations obliges them to operate as quasi-for-profit organisations. And the character of their operations alone (micro-finance) does not necessarily justify an adapted supervision regime, unless it can be demonstrated that the protection of the depositors does not suffer from an adaptation of the supervision standards.



## II. TYPOLOGY

12. The micro-financing segment of the Financial Services Industry in Bangladesh, India, as well as in most African countries consists of three broad fragmented sectors: formal, semiformal and informal - reflecting the degrees to which each are regulated. The formal sector includes all regulated institutions, including banks, non-bank financial institutions and insurance companies. The semi-formal sector includes institutions that are otherwise regulated but which fall outside the formal oversight function of the Central Bank, Insurance department and the Securities and Exchange Commission. This sector is mostly occupied by Non-Governmental Organizations (NGOs), and particular government programmes. The informal sector includes private intermediaries who are completely unregulated, such as friends, shopkeepers, moneylenders, Rotating Savings and Credit Associations (ROSCAs), and building societies, mutual fund operators, and traders and dealers in agricultural markets.

13. MFIs in Central America exist under different ownership regimes, either state-owned, private or co-operative. Some of the MFIs are specialized institutions that entirely concentrate on the provision of financial services, while others combine micro-finance programmes with other development activities. Among the specialized MFIs, a distinction can be made between APEX-type institutions with second-tier operations, and institutions that provide direct (first-tier) services to targeted clients. These distinctions lead us to the following descriptive typology:

Specialisation → Ownership	Specialised MFIs		Other institutions with MF activities
	Second-tier	First-tier	
State	Public APEX funds	Agricult. dev. banks Housing banks	IRD projects Microenterprise projects
Private For profit	---	Private banks	Traders, (agro)industry
Private Not-for-profit	Private APEX funds	Financial NGOs: ▪ "Crédito solidario" ▪ Village banking ▪ Individual loans	Development NGOs
Co-operative	Federations of credit unions	Co-operative MFIs: ▪ Credit unions ▪ Village banks ▪ "Cajas rurales"	Marketing & service co-operatives

14. **Public APEX** activities have operated for decades as special discount facilities within the Central Banks. They were mainly financed with bilateral and multilateral funding, and during the sixties and seventies were open preferentially to the public development banks for agriculture and housing. Lately the public APEX funds have taken an interest in NGO activities, in part because the most solid financial NGOs are submitting themselves to the supervision and therefore become eligible for APEX funding. Also several donors have deposited special trust funds under the administration of the APEX institutions, thereby involving them in the funding of non-regulated MFIs. Apart from national APEX funds that have their institutional origin within the central banks, some development projects are setting up specialised APEX funds to administer their second-tier credit operations. One example is a series of micro-enterprise programmes promoted by the ILO in several countries, that have operated second-tier funding through NGOs and credit unions during several years and are institutionalising these funds in the form of autonomous programmes, funds or even second-tier banks. Another example is IFAD that is developing second-tier funding for rural MFIs within the framework of IRD projects in Nicaragua, Honduras and Panama.

15. The **public development banks** had been introduced early in Costa Rica, where the banking system was virtually nationalised in 1948,<sup>1</sup> backed by capitalist entrepreneurs seeking to break the financial monopoly of the conservative landholders. In the remaining countries of Central America, the fundamental motive behind the creation of public development banks in the 50s and 60s was largely the same, although it was explicitly combined with the anti-insurgency consensus of the Alliance for Progress. Public development banks, with the exception of Costa Rica, depended heavily on the special discount facilities of the Central Banks. Their loans were directed mainly to national agro-export farmers and to land reform co-operatives. Some of the agricultural development banks are now trying to reshape their micro-credit activities by developing second-tier lending through NGO and co-operative institutions (Bank-Rural Guatemala, BANADESA Honduras), and thereby implicitly recognise that their lending technology is not suitable for the purpose of first-tier micro-credit. This model of second-tier lending has been operated for more than a decade by the public housing banks of Costa Rica, Guatemala and Honduras, but the experiences of public banks with second-tier operations for rural micro-lending have not yet proven successful.

16. The state also provides micro-credit through **development projects** that generally integrate financial and non-financial activities. In the rural areas, these initiatives typically take the form of projects, where credit funds are somehow combined with agricultural extension services, social development and/or infrastructural investments. Despite a growing awareness that credit funds should be converted into sustainable local institutions, the credit activities of most rural development projects are put to use as leverage instruments for technical or social change, rather than a useful service in itself. In urban areas, economic development projects often are directed towards small and micro-enterprises. Most micro-enterprise projects have been set up during the late 1980s and early 1990s throughout Central America, generally ILO-supported, and are currently being institutionalised as national programmes, institutes and/or autonomous APEX funds.

17. **Private banks** have not entered strongly in the micro-finance business in Central America. Induced both by the Superintendents rules on collateral and the existence of investment opportunities that are perceived as more attractive in terms of risk and return, banks in Central America generally perceive micro-credit as a non-profitable or sometimes charitable activity. Their involvement in small-scale finance is therefore mostly explained by operations on the account of third parties (trust funds). Recently, however, several banks have entered the segment of urban small enterprise, motivated by the promising results of several NGOs that for example specialise in daily lending to female vendors in the urban markets.

18. **Private traders and (agro) industries** have traditionally played an important role in financing their small-scale providers, as a strategy to protect their market. There is an infinity of arrangements, both in rural as in urban sectors. Little is known about the evolution of these arrangements over the decades. During the 1990s however several studies have been carried out that highlighted the relative importance of informal credit as a source of finance for entrepreneurs.

19. **Private APEX funds** for micro-credit exist in some of the countries as not-for-profit institutions (ACORDE in Costa Rica, Fundación Covelo in Honduras). They were typically founded halfway in the 1980s in an alliance between US-AID and the national business society. Created as platforms to support small enterprise, they evolved into APEX organisations towards the end of the 1980s. Because of the small number of viable first-tier MFIs and the subsequent problem of scale for their second-tier portfolio, they currently combine second-tier lending and first-tier operations in urban micro-credit (see González Vega, 1998).

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<sup>1</sup> Actually it was not the legal concept of a bank that was nationalized, but rather the right to take deposits from the public (sight deposits and term deposits shorter than 180 days) was monopolized in favor of state-owned banks.

20. **Village banking** is most successfully applied in semi-urban areas and rural towns, predominantly with women in non-agricultural activities. A relative exception is FINCA Costa Rica, which includes men and women and combines agricultural and non-agricultural activities in its portfolio. Also the FAO-induced experiment with “cajas rurales” in Honduras may be interpreted as an application of village banking to rural areas. Most of the financial NGOs are urban-oriented, although several rural MFIs exist as well; also the portfolio of financial NGOs in smaller and rural cities is gradually growing.

21. The dominant financial mechanism among the financial NGOs may be divided into three categories. One is the so-called “crédito solidario”, which is a methodology of joint liability groups (4-8 members) developed by ACCION International and applied mostly with women in urban areas. The second one is village banking with village banks typically in the range of 20-30 members. The third group of financial NGOs provides individual loans with procedures adapted to micro and small entrepreneurs: simple and very rapid approval procedures and very frequent payments. This last lending mechanism is easier to implement by banks, as may be demonstrated for example by Banco Popular in Nicaragua and Banco del Comercio in Costa Rica.

22. The **credit unions** in Central America date back to the 1950s and 1960s, as an important branch of the rise of co-operative organisation in the region. Because of a weak regulation and supervision structure, the credit unions have experienced periods of rise and fall during the last decades. In Costa Rica, Guatemala and Honduras, the credit union movement is now relatively strong and is being represented by federations that fulfil three basic functions: maintaining financial discipline within the credit unions, providing strategic services on a second-tier level, and negotiating with the regulatory authority and other third parties. In these three countries the federations provide financial and non-financial services that are scale-sensitive (liquidity arbitrage, insurance, auditing, supervision, technical assistance). These services were crucial for the expansion achieved by the credit unions system during the 1990s, as it filled part of the credit gap that was left by the banking system during the economic stabilisation policies. As a result of this expansion the credit unions sector in, for instance, Honduras and Guatemala, has structural liquidity surpluses of about US\$ 10-15 million. In Costa Rica the credit unions achieved to establish a financial holding with their own bank, auditing service and offshore bank.

23. Finally, **other co-operative organisations** have operated loans, often as an integrated part of marketing services. They offer advances to small-scale providers, which are members of the co-operative, or in other cases, sell products on credit. A typical and widespread case is the coffee marketing co-operative, which is a rather mature model in Costa Rica with protective legislation, but in countries like Honduras, Nicaragua and Guatemala, has encountered many problems. More isolated cases exist in input marketing (fertiliser for agriculture, raw skins for leather workshops, etc.), and other enterprises (dairy products, fruits and vegetables).

24. Unfortunately there exist no systematic statistics on the market shares of the different types of MFIs. Obviously the banking sector is by far the biggest in total assets, but for the micro-finance markets information is lacking except for Nicaragua. A very preliminary estimate for Nicaragua shows that private banks, public banks and non-regulated institutions each roughly account for one third of the number of clients in the category of micro and small enterprises. The average loan amounts for micro and small firms were three to four times higher in the case of banks compared to the non-regulated institutions.



### III. CASE STUDIES IN SOME AFRICAN COUNTRIES

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25. In the last few years, African micro-finance institutions have made considerable progress despite the fact that they were newly established as compared to similar institutions in other parts of the world. They bring together a wide variety and a large number of institutions. The services provided meet the needs of a low-income population who do not have access to the formal banking system, even if nowadays the conditions are not adequate, and all requirements are not satisfied. Their role is crucial in poverty alleviation, which is now a priority among African States.

#### A. Cameroun

##### 1. *Women Credit Savings (WCS) Programme*

###### a. Origin

26. "Women-Credit-Savings" (WCS) has been designed and implemented by the Association for Assistance and support to Business Women as a non-profit-making, development – oriented NGO with no political leanings, established in 1987. Its objectives are to:

- (a) Develop micro and small enterprises;
- (b) Promote self-employment through the development of a dynamic and performing entrepreneurship;
- (c) Promote access to credit for groups of individuals and small enterprises with no access to bank loans either due to the low volume of their activities or to the lack of the traditional guarantee required by the banks;
- (d) Strengthen organizational and management capacities of enterprises and grass-root organizations; and
- (e) Ensure the protection of the environment in the implementation of projects.

Its clientele is drawn from enterprises or micro-enterprises led by women as well as young people from both sexes.

27. The WCS Programme, modelled on the Indian SEWA Programme (Self-employed Women's Association), is targeted at poor people. Credit is provided for investment and for a revolving fund as well as for technical assistance and advisory services to economic operators. It includes information, training and monitoring activities. Initially, it was confined to the urban area (Douala and its environs). The approach is participatory. It combines traditional practices in Cameroon with modern techniques of micro-financing. The linkage between savings and credit, lies in mobilizing savings and the direct distribution of credit, solidarity guarantee, social control over the use of the funds and the rights of groups to oversee the utilization of the funds etc.

28. The programme started in 1993 with training in the techniques of social mobilization, the identification of activities and the formulation of appropriate teaching materials on management and evaluation. They hold training workshops which bring together the local trainers of SWE and the women leaders in groupings and associations with solid guarantees (generally the

members of the elected Executive – President, secretary, treasurer). Financing is provided by the French Ministry of Co-operation and Development (MCD) and the General Board of Global Ministries in New York.

#### **b. Lending methods**

29. The programme uses two systems of providing loans: (a) Credit for persons constituting themselves into solidary guarantee groups and; (b) individual loans for very seasoned “business people” who can provide collaterals.

##### *(i) Credit for WCE*

30. Operational credit is given to women and young people who can form a group and provide guarantees, and should have at least five people. These various solidarity groups can later become associations. A guarantee of FCFA10000 is required from each individual, and the guarantee required for the subgroups is at least FCFA35000. A supplementary individual guarantee or security saving is deducted from the loan, which is five per cent. Access to credit is done on rotation and the group sets the order. This access to credit is suspended in the event of failure or delay in the repayment schedule from the group. The social pressures from people waiting for loans and the acceptable conduct of its members are the principal mainstay of the programme.

31. Loans are initially limited to a six-month repayment period and repayments are made fortnightly or monthly in accordance with the option made by the group or the association – The ceiling figures for the second, third and fourth loans increase gradually together with their repayment periods. The increase in the ceiling figure of a loan is contingent strictly upon the successful repayment of a previous loan by the group. Guarantees are made to suit the specific situation or the particular type of activity undertaken by the women or the young people. The monitoring mechanism provides valuable information on group activities and/or associations, assess the “tontine” – association relationships as well as the management of credit and savings. The latter includes the composition of associations, the savings and the state of the savings credit positions, analysis, the activities of members, sounds the opinions of the members of the organization, and the operations of the groups and the associations, as well as the modalities governing credit and savings.

##### *(ii) Personal Loans*

32. Candidates should have a proven track record of receiving and managing loans. The guarantees required include: deduction from the salary of the person taking the loan or his guarantor, or deposit personal belongings as collateral. In the WCS programme loan is given as a priority to members of the group with sound collateral with exceptional success and who now exceed their last ceiling figure of FCFA600000. Their credit needs are now outside the scope of group collateral system. If a local bank does not provide them with credit, WSE is committed to guiding them to become a small enterprise in cases where they are viable to produce collaterals. They are now simply products of WSE. They can now be regarded at least as the WSE “Success stories”.

#### **c. Impacts of WCS**

33. As at 31 December 1997, WCS had in its account: (a) 52 sites in the city of Douala and its immediate environs; (b) 4200 active members in the programme; (c) provided 2300 loans with an average total sum of FCFA200000; (d) provided 57 per cent of its own finances from the interests on loans and deposited collaterals; and (e) undertaken various activities.. The activities undertaken include trade, agro-food, manufacturing activities and small-scale animal husbandry.

### Other results:

(1) The programme has attracted about 4,200 active members in Cameroon and these are people from Central and West Africa. It meets their real needs, notably women who have no access to bank loans, partly because their loan requirements are very little, or because their micro-enterprise activities are mainly conducted in the informal sector and they have no collaterals as required by the banks.

(2) For persons who started their micro-enterprise through their own resources, WSE provides assistance for the strengthening of the revolving fund and infuses new dynamism into their activities. For other micro-enterprises, SWE provides assistance to enable them to be self-reliant through self-employment.

(3) Solidarity groups are now already well in control of credit modalities and recovery: On the other hand through training, sensitization, beneficiaries have now taken into account cost price as a factor in their pricing system, which was previously not clear to them. They have now mastered the pricing system and reduced losses to a minimum in their earnings.

(4) Some members of associations have started a communal project through savings that they have mobilized. The members have attained, as a result, a greater sense of responsibility and respect for their commitments. Finally the members of the various associations increasingly view this programme as a partnership to assist in the challenges posed by the economic crisis.

(5) The members of the association develop and demonstrate greater confidence and sense of purpose in their activities. In most cases, repayments do not pose a major problem. Consequently, there is an improvement in the social status of the members of WSE particularly women.

(6) The SWE programme has developed mechanisms like the group collateral, feedback, participation etc... that should lead to risk-taking that customers would well appreciate.

The programme is a link between rural and urban areas. More than 50 per cent of the women involved in the programme are in very close touch with the rural areas. They derive their earnings from these areas where they secure basic raw materials. They later process these materials in the cities or on the spot and only send finished products to the urban areas. Alternatively they develop activities in the rural areas with the assistance of farmers (banana-plantains, cassava, yam plantations, groundnuts, bee-keeping, etc.)

## **2. Community Development Organizations (CDOs)**

### **a. Origin**

34. The Common Savings and Investment Bank (CCEI) is the brainchild of the CDOs. It is a limited liability company with a capital of 3 billion francs CFA. It has the status of a commercial and investment bank. It also operates as a development bank. It aims at establishing a link between the formal banking system and informal savings for savings mobilization among the local populations through innovative techniques. CDOs is therefore a promising pilot experience in the development of micro-financing. CDOs aim at contributing to poverty alleviation. The bank is conscious of the fact that in the past the rural areas were not adequately involved in the development process.

35. In 1992 the Community Growth Organization (CGO) was set up to alleviate poverty in the rural areas. The aim of CGO is to promote a culture of savings and credit development in the rural areas so that they can cater gradually for themselves. To this end, they are trying to decentralize banking operations in the remote and land-locked areas of Cameroon. These are associations under the purview of the Ministry of Local Government. They have management support from the CCEI Bank, which is supported by the German Foundation ADAF (Appropriate Development for Africa Foundation) in its financial management. CCEI has also received a Canadian subvention covering 50 per cent of its operational costs.

36. Its approach is first of all to sensitize rural communities about the need for savings and credit from the informal sector. Once interest is generated and they are keen to become members of the programme, CCEI assists them to form associations and groups and provides training in management and evaluation. They freely elected their officials and put in place the structures they consider appropriate for the implementation of operations. Membership can be acquired through a subscription of FCFA2500. By making an initial payment of FCFA5000 to its foundation fund and undertaking to make regular payments of at least FCFA1000. This fund has social component divided into FCFA1000 (minimum FCFA10000). Membership of CGO is open to any person who wishes to improve his or her social condition be they farmers, housewives, business people and artisans.

37. The structure of CGO is generally composed of: (a) Council of wise men whose members are co-opted on the basis of their social positions and their moral authority in society; (b) a General Assembly bringing together all the members; (c) a Governing Board elected by the General Assembly and (d) an Executive Secretariat comprising the Executive Secretary, the Treasurer and accountant.

#### **b. Loan procedures**

38. The powers to grant loans lie with the Board of Governors which also serves as the Loans Committee. To be given a loan, the following criteria should be met. The client should be known and the necessary guarantees provided. These guarantees are usually objects of great socio-cultural value in the country and in the eyes of the population. These items are usually inherited and handed over from one generation to another and has great significance to the family or the clan. They are normally woven materials used in traditional ceremonies, huge bracelets with ivory tops, dance accessories, lion and panther skins etc. Generally, the interest rates on loan range from one to two per cent monthly. The maximum period for loan repayment is 24 months.

39. Loans cover handicraft activities, improvement of homes, various ceremonies (weddings, funerals, naming ceremonies etc.) back to school, development of agricultural, industrial and commercial activities. The annual rate of interest on savings is freely negotiable.

The procedure is simple and the Loans Committee is the only body with powers to decide on interest rates for deposits.

#### **c. Socio-economic Impact**

40. As at this date, CCEI Bank has been involved in the establishment of 48 CGOs throughout Cameroon. Of this number, 21 are operational in various provinces. The best CGOs include Melong (in the coastal province), Bangangte (in the West), Muyaka (in the South-West), Bambilang (in the North-West etc.) Some of the CGOs in operation are already viable. They have more than 10,874 members and have mobilized 1,720 million (1.7 billion CFAF) and have implemented many community projects. In Melong, the 1776 members built three coffee factories with a loan of 831 million FCFA for the processing, shelling, grading and jute bagging for export. Melong has a cherry farm. Muyaka has 412 female farmers. Credit of 380 m FCFA

was wisely used by the members to set up a modern project for the production + export of cherries. There is some mechanisation and the women have been provided with training in appropriate agricultural techniques. There is a refrigerated truck for the transportation of products to Douala. In Baham, a goat farm has been established. In Bangangte, there is a coffee factory and pipe-borne water at Bambalang. These projects have given life once again to the countryside which was increasingly affected by the economic crisis.

41. CDOs is a sort of micro-bank in the generally remote and land-locked areas. It encourages people by assisting them to support viable projects and to be self-supportive through their own development efforts. Furthermore, through job-creation and income distribution to farmers, farmers are no longer attracted to go to the cities. CGOs have made farmers to be aware once again of their cultural values which they had forgotten or neglected by converting some of their traditional possessions as instruments of loan guarantees. However, the fact that CGOs has CCEI Bank as its partner and has made CCEI responsible for the organization and supervision of the management is an indication of good apprenticeship and security for the savings of its members. CDOs can therefore serve as credit distribution points for credit locally or externally mobilized for the rural population. The CCEI network would facilitate the transfer of funds between the various organizations. The CGOs is an interesting experience albeit new and many lessons could be learnt from it. With adequate support, CGOs could fulfil the functions of micro-agricultural banks financing local and rural micro-structures. A factor hindering its development at the moment is the unsuitability of the existing laws. In the law No. 92/006 dated 14<sup>th</sup> July 1992, only cooperatives and savings and credit cooperatives are placed under the purview of the Ministry of Agriculture. CGOs are considered as simple associations under law No. 90-53 dated 19<sup>th</sup>.December 1990 on the freedom of association.

### **3. The Cameroon Cooperative Credit Union League (CAMCCUL)**

#### **a. Origin**

42. The CAMCCUL was established in 1973. It was a federation of 34 people's banks from the West Cameroon Credit Union League (WCCUL) in the English-speaking area of Cameroon. At the moment, it brings together in 10 sections 10 to 20 people's banks depending on the localities. It is affiliated to the African Cooperative Savings and Credit Association (ACOSCA) and the World Committee of Credit Union (WOCCU). The League undertakes the following activities: (a) representation, supervision and counselling; (b) interpreting the law and the regulations providing guidelines for the promotion and development of people's banks; (c) providing stationery, computer development in people's banks; (d) centralization of services has brought about an economy of scale. As a contribution to these services, each bank pays to the League 0.02 per cent of its savings every year with FCFA15000 as a minimum. This system of tariff for services enables the League to acquire a regular source of income to control the scope of activities of people's banks which constitute its clientele.

#### **b. Methodology**

43. CAMCCUL provides a certain number of services such as deposits, deposit and credit insurance for peoples banks, credit for women, etc.

##### *(i) Constitution of social shares*

44. To be a member of the League, the institution has to be a people's bank. Each bank has to deposit in June and December of each year 20 per cent of its savings to the League on a fixed deposit account. These funds are used to meet the financial requirements of the members. Any people's bank with excess liquidity has the option to save it on a special fixed deposit

account or on a regular deposit account. Withdrawals could only be made from these two accounts in writing and payment can only be effected within six months. On the other hand, withdrawals from the current account could be made at any time by a simple request. The League pays dividends on the shares in cases of excess. Fixed term deposits earn six per cent interest annually, and special fixed deposits earn 6.5 per cent, while the interest rate on current accounts is one per cent.

*(ii) Risk management*

45. People's banks can also seek membership of an insurance programme (risk management) to cover risks involving death and permanent disability. Maximum liability is FCFA500000 for savings and FCFA2500000 for loans to members between the ages of 18 and 69 years. Insurance premium is paid through a contribution of 100 by tranche of FCFA100000 from savings and loans, while claims vary depending on the age of the person insured. CAMCCUL also pays a commission of 2.5 per cent on its shares and savings to the people's banks involved in this programme. The interest rate of savings of members more than 70 years old is five per cent to encourage them to have more savings.

*(iii) Credit for Women and Development (CPWD)*

46. The people's banks could become members of the Credit Programme for Women and Development (CPWD), which aims at assisting members to be engaged in income-generating activities through financial support and management training. The League is responsible for meeting the cost of the training, while the monitoring is done by the people's banks.

*(iv) Services provided by the people's banks*

47. Depending on their location, CAMCCUL makes a difference between the rural and urban banks. The banks can bring together residents and inhabitants of the same community, employees of the same enterprise or even employees of the same profession such as the police etc. Any person wishing to become a member of the bank buys between one and ten shares valued at FCFA1000. Members can place their savings in a deposit account or in a saving account. A written request must be made before an account is closed, with six months notice, whereas the time limit for a withdrawal from savings is three months. Sums placed in a deposit account are not taken into account when requests for loans are made.

48. From its base to the apex of the pyramid CAMCCUL is made up of people's banks, the sections and the League. At all levels (namely league, sections, peoples banks) power is in the hands of elected representatives known as the Governing Board. This board is subdivided into various committees (namely loan, education, women and development ...). Each people's bank elects the members of the Governing Board during the General Assembly for a term of three years. Two representatives for the section are among the elected members. Each section in turn and depending on its size selects one or two representatives to sit on the Governing Board of the League. The Annual General Assembly of the League brings together all the Chairmen of the affiliated people's banks, which elects its chairman every three years from the members designated by the sections.

49. The Governing Board presents a management report to the Annual General Assembly, all the people's banks and their development and monitoring plans in their finances, such as: savings accounts for special events (birthdays, funerals, back to school, new year celebrations). The bank pays dividends on the shares when profits are made and the dividend rate should not, according to the law, exceed the prevalent interest rates of the commercial banks. The interest rate on loans is 1.5 per cent per month, or 18 per cent per annum.

### **c. Socio-economic impact**

50. CAMCCUL aims at providing savings and credit services to the rural and urban populations. The results achieved have been considerable: The willingness to save has increased, more women are becoming members and the services provided by CAMCCUL has been on the increase throughout the country. As at 31 December 1996, CAMCCUL had 296 people's banks and more than 102771 members. It has mobilized 14 billion FCFA (more than \$US 273) of savings and shares either by an average number of FCFA136178, and in all, 80 per cent of shares and savings of the entire savings and credit co-operatives of Cameroon. Twenty-four per cent of its members are women and loans to women in 1995 accounted for 34 per cent of the loan given to CPWD. Three factors account for the trust of its members and the performance of CAMCCUL:

- The trust of its members. The members are the owners of their co-operative and they participate in its management through the election of its administrators. The administrators and personnel are regularly trained to maintain the quality of services. Audit exercises, periodic checks and publication of the institution's performance during the general assemblies reinforce the confidence of the members in the institution.
- Deeply-rooted in the North-West and Southeast provinces and regions, CAMCCUL is now operating in the Western provinces, the Coast, Central and South Region, and recently in the extreme north, namely seven out of ten provinces of the country. This shows the success of CAMCCUL.
- The sensitization efforts made by CAMCCUL have resulted in the emergence of great savings capacity in some regions, particularly in the coffee and the cocoa growing regions, where purchases made once or twice a year have encouraged farmers to save.

Most loans are directed at sectors such as education, health and housing. Members of the CAMCCUL banks give priority to their welfare and that of their children. In 1996 the share of loans to agriculture accounted for seven per cent of the volume. The people's banks provide complimentary services to operators in the informal sector and work closely with this sector.

## **B. The Central African Republic (CAR)**

### **1. VITA – Micro-enterprise Project**

#### **a. Origin**

51. VITA is a private organization of volunteers with a non-profit aim. It was set up about 30 years ago by a group of scientists and engineers to share knowledge, skills and experience with people from developing countries. VITA volunteers develop new technologies or identify those technologies which meet the needs of local people. The objective of its services is to make them self-sufficient through the development of capacities by the people to use their resources in a more efficient and viable manner. VITA collects and disseminates, various forms of information on technology. VITA provides services for remote regions in developing countries, particularly technical training in the "management of information resources," and publishes brochures and technical papers.

52. The project provides financial support for investment and the strengthening of the revolving fund for dynamic economic operators who have no access to bank loans. It seeks to assist small entrepreneurs who have no access to loans from the formal sector. They work directly with the informal sector. It is an intermediary between the informal sector and the formal financial sector as they assist operators in the formal sector to work with the banks. The project started in Bangui in January 1990 through support funds provided by the World Bank under the credit project for the rehabilitation of Enterprises (PARDEP). The aim of the project is to assist small entrepreneurs to meet operational costs. Credit is provided in kind or cash to groups (solidarity credit), and to individual entrepreneurs. The entrepreneur participates in the savings.

## **b. Methodology**

### *(i) Solidarity Credit (SC) or the Credit Group*

53. The Solidarity Credit is given to groups of individuals who do not possess securities for loan reimbursement. The solidarity guarantee ensures that each member of the group is responsible for the loan of the other in the case of default, while still responsible for his own. The maximum loan repayment period is 24 months. To have access to credit, the person should be developing an operational and viable project, provide capacity to reimburse the loan and be based in Bangui or Bambari, or within 25 km radius from the city. A person must be a member of a solidarity guarantee group composed of three to five persons and to contribute a maximum of 30 per cent to the total cost of the project.

54. The developer should pay a fixed service charge at the rate of four per cent of the cost. We should also make a payment to the guarantee fund at a fixed rate of five per cent of the loan in question. These funds constitute the guarantee for the group and individual savings for the members of the group. These amounts taken are considered as one and therefore cannot be separated. The guarantee fund is reimbursable to the customer if other members of the group have no liabilities. The cost for preparation of individual files was fixed at FCFA500. The loan reimbursement for a group of three people was a maximum of three months and four months for a group of four people. Initially the minimum credit sum was FCFA40000. Generally it was revised upwards whenever renewed if the group met the required repayment conditions. The ceiling figure therefore remained open. The procedure is simple: The client should make a loan request, provide a description of the project, a cost estimate of real production costs, and the expected benefits, an identity or photocopy of a recent national identity card, or birth certificate.

### *(ii) Personal Loans*

55. It plays a complementary role as far as commercial banks are concerned to strengthen enterprises with proven capacity to manage loans and enterprises showing solid commercial plans from the technical viewpoint. The project provides technical and financial assistance to entrepreneurs to secure loans. To access loans, the beneficiary: (a) must be based in Bangui, or within 25 km radius at most from the city, (b) use local raw materials and contribute a minimum of 25 to 30 per cent of the total cost of the proposed activity. Generally, the maximum loan period is 18 months. The sum of the loan varies from FCFA100000 to FCFA2500000 but the ceiling figure is determined by the nature of the project. The guarantees required are: deduction from the salary of the entrepreneur or his guarantor and equipment or personal properties. The procedures are similar to those for solidarity credit. The project combines sensitization and training, and aims at greater development of activity after credit for customers. The project takes the form of:

- Discussions over the radio and television
- Posters on its activities and how to become a member

- Organization of conferences/debates or workshops or participation in seminars organized by other institutions on enterprise creation or on issues of credit and savings.
- Operation of a mobile publicity van used as a counter/information outlet.
- Sensitization meetings for the good use of credit for beneficiaries before disbursement.

56. Credit goes along with training, which is vital for customers to gain access to the formal sector for effective participation in the development of the country. Savings mobilization is not the main activity of the project. Setting aside 5 per cent of the principal loan to solidarity groups is meant for the establishment of a guarantee fund.

### **c. Socio-economic impact**

57. VITA micro-enterprise revived a state fish-farming station that was moribund. At the same time it provided employment opportunities for members of the association called GAP, where most members had lost their jobs. It provided job opportunities in these areas, namely, small-scale animal husbandry, vegetable gardening, sewing and they became economic operators whose activities were beneficial to society. The VITA MICROFINANCING is providing assistance to 75 persons to meet their health, education, transport and clothing requirements. GAP has already won two major national awards, namely, the prize for the best association in 1990 (prize sum FCFA 2000,000) in Berberati, and the prize for the best fish-farming in 1993 in Bossangoa (prize sum FCFA 150,000).

58. The GAP fish-farming station covers an area of 39 hectares and has its own statute and operational bodies, such as its general assembly, which is held once every year, the Executive Committee composed of five members which holds its meeting twice a month, and a management committee of two members. GAP's strength lies in its organization and the professionalism of its members. GAP operates efficiently and demonstrates transparency in its financial operations. Two other women's organizations are associated to GAP, namely, SEWA, which is in small-scale animal husbandry, vegetable gardening (18 women) and GMCE is in sewing and animal husbandry (8 women). Results of the last financial years' activities:

- (a) Fish-farming 12<sup>th</sup> harvest (September 1994 to March 1995); FCFA 1,386,680 13<sup>th</sup> harvest (September 1995 to March 1996); FCFA 3,881,380;
- (b) Agriculture (93/94) (income) vegetable gardening: FCFA 870,395. Food crops FCFA 967,580;
- (c) Agriculture (94/95) (income) vegetable gardening FCFA 1,800,000. Food crops FCFA 2,650,000; and
- (d) Agriculture (95/96) (income) vegetable gardening: FCFA 2,500,000.



## IV. CASE STUDIES IN SOME ASIAN COUNTRIES

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### A. Bangladesh

59. The Financial Services Industry in Bangladesh consists of three broad fragmented sectors; formal, semiformal and informal - reflecting the degree to which each is regulated. The formal sector includes all regulated institutions, including banks, non-bank financial institutions and insurance companies. The semi-formal sector includes institutions that are otherwise regulated, but which fall outside the formal oversight function of the Central Bank, Insurance department and the Securities and Exchange Commission. Non-Governmental Organizations (NGOs) and particular government programmes mostly occupy this sector. The informal sector includes private intermediaries who are completely unregulated, such as friends, shopkeepers, moneylenders, Rotating Savings and Credit Associations (ROSCAs), and building societies, mutual fund operators, and traders and dealers in agricultural markets.

#### 1. Polli Karma Shahayak Foundation (PKSF):

##### a. Origin

60. In 1990, the Government of Bangladesh set up the Polli Karma Shahayak Foundation (PKSF), an apex funding institution to assist promising small and medium NGOs expand their poverty targeted micro-credit programmes. The PKSF is registered under the Companies Act of 1913 as a private non-profit organization. PKSF is the biggest and most successful apex institution for micro-credit programme in Asia. Its independent and autonomous governance structure and prudent operating policies provide a good foundation for rapid and sustainable expansion of its micro-financial services.

##### b. Methodology

61. Maximum loan to Partner Organizations (PO) generally cannot exceed 10% of available funds. PKSF follows a conservative policy for first time POs by starting with a small loan and gradually increasing loan sizes. It encourages its POs at least to cover the recurring credit administrative/funding costs from interest income, and imposes a minimum lending rate of 16 per cent interest to promote cost recovery from operations. PKSF mandated that all POs must have members savings programmes and generally requires that these savings be kept in regular bank accounts

**Table-1: Fund Sources and Number of NGOs as of December 1997.**

Source	NGOs Utilizing the Source	
	Number	%
PKSF	75	19.74
Local Bank	25	6.57
Foreign Donor	163	42.89
Others	362	95.26

*Source: CDF Statistics, Volume 5, 1997*

62. The PKSF has received its funding, a total of Tk.750 million, from government. The World Bank poverty alleviation micro-finance project provided for a line of credit of \$109 million for MFIs. The funds are on-lent from the government to PKSF at an interest rate of 1 per cent

over twenty years, with a five years grace period, PKSF then on-lends to MFIs that meet various criteria, at interest rates ranging 3 - 5 per cent. About 60% of the line of credit is earmarked for small and medium MFIs, and 40% for large MFIs. Savings of the NGO-MFI members are another source of funding. The data from CDF publication shows that 380 NGOs have mobilized Tk. 4258 billion from the beneficiary members' savings. However, savings mobilized by the NGO-MFIs are far below their credit portfolio.

### **c. Socio-economic impact**

63. As on September 1998, PKSF has disbursed loans amounting to Tk. 11.4 billion to 147 Partner Organizations (POs), who work in more than 21,000 villages of 313 Thana of 58 out of the total 64 districts of the country. The POs have used the fund to provide loans to 1.2 million rural poor borrowers of whom 92 per cent are women. PKSF's loan recovery rate is above 98%. The poor borrowers have saved a total of Tk.973.1 million.

## **2. Bangladesh Small and Cottage Industries Corporation (BSCIS)**

### **a. Origin**

64. Micro-credit projects of the Bangladesh Small and Cottage Industries Corporation (BSCIC) under the Ministry of Industry includes, a) Self-employment for Rural Destitute Women Through Cottage Industries (SERWTICI), b) Women Entrepreneurship Development Programme (WEDP), c) Poverty Alleviation Project through Income Generating Activities and Self Employment Project. The micro-credit project SERWTICI was initiated by BSCIC in 1986 with the objective to improve the socio-economic condition of destitute women by promoting income-generating activities. In July 1996, it has been transformed into a Trust.

### **b. Methodology**

65. Women Entrepreneurship Development Programme (WEDP) which also operates under Bangladesh Small and Cottage Industries Corporation was started in 1982 with financial support from USAID. The primary goal of the programme is to assist women in low-income groups in selected areas who are already entrepreneurs or have potentials to be entrepreneurs. WEDP provides small loans to finance both working capital and fixed capital to enable women to set up small industries with locally available raw materials. Loans are given through selected branches of BKB. The facilities and raw materials of the enterprise are treated as collateral against loan. Working capital loans are issued for one-year term and the fixed capital loans are for five-year term and the rate of interest in both cases is 16.

### **c. Socio-economic impact**

66. For SERWTICI, as on June 1998, Tk.111.0 million was disbursed among 15,492 women beneficiaries and the members have group savings amounting Tk. 12.5 millions. %. For WEDP, as on June 1998, total amount of Tk. 351.98 million was lent to 69690 women members through its branch offices. The size of loan ranges from Tk.5000 to Tk.60,000 and repayment rate is 95%. During same period BSCIC through its two other projects has disbursed microcredit amounting to Tk.179.9 million to 9051 members, and repayment rate ranges from 63% to 100%. The Department of Rural Social Services (RSS) under the Ministry of Social Welfare has undertaken a number of poverty alleviation programmes for destitute people in 9936 villages, and credit is a major input. As on August 1998, total amount disbursed was Tk. 245.1 million to 151650 members and recovery rate is 98%. The RSS also organizes groups of women into Mother's Clubs, with the objective of improving the socio-economic condition of women. The Mother's Club project started in 1975 and as on October 1998, the project had loaned a total of Tk.209.2 million to 515701 members.

### **3. Bangladesh Rural Development Board (BRDB)**

#### **a. Origin**

67. The Bangladesh Rural Development Board (BRDB), under the Ministry of Local Government, Rural Development and Cooperatives, is the main agency for executing the Government's poverty alleviation and development programmes. The BRDB was formed in 1982. It is an integrated rural development programme implemented through organization of two-tier cooperative societies for which credit is the key input. BRDB has organized agricultural societies (KSS), women's societies (MSS), societies for men (BSS) and women (MBSS) without assets, which are affiliated with the Thana Central Cooperative Association (TCCA). Its Rural Development (RD-12) programme has performed very well compared to most other government micro-finance programmes both in Bangladesh and other countries. With its innovative design, the project has drawn considerable resources from Canadian International Development Agency (CIDA), as well as interest from other donors and policy-makers.

#### **b. Methodology**

68. The project borrows heavily from the experience of Grameen Bank and NGOs involved in micro-finance, with lending methodology based on the Grameen Bank model. The project provides credit, skill development training, organizational help and other human development inputs to the rural poor. The programme is based on cooperative structure, where participants are mobilized in groups of fifty to sixty, separate societies formed for men and women. The RD-12 project forms 'solidarity' groups of four to five members, working under each society, to allow more effective monitoring of group's performance. The project targets the poor who depend on manual labor and do not own more than half an acre of land. Savings mobilization is an integral part of its activities. Once the poor are mobilized into groups and become members of the societies they are required to save certain amount each week and buy a society share of Tk.10 every year.

69. The primary societies hold weekly meetings where the loan applications of individual members are discussed with other members in presence of the project field organizers. The eligible members borrow no more than Tk. 10,000 per year at 15 per cent interest rate and repay loans on weekly basis in fifty equal installments. As on October 1998, a total amount of Tk. 4.7 billion was disbursed as loan to 412756 members of which 72 per cent are women and repayment rate was 97%. Number of villages covered was 16,903. The borrowers are also required to contribute five percent of the principal loan amount to a 'group' fund, which is refundable with interest if the members decide to leave the programme. Total savings accumulated by the members were Tk.363.5 million, and share purchased by the members was Tk. 51.6 million. The members are paid interest on their savings at the bank rate.

#### **c. Socio-economic impact**

70. In June 1998, there was a total of 121,096 primary cooperative societies with a membership of 3.9 million people, of which 26 per cent were people without assets, and 26 per cent were women. The members share capital was Tk. 487.9 million and savings were Tk. 1.4 billion. A total of Taka 20.1 billion had been extended as credit, including Taka 2.2 billion as term credit. Overall recovery rate is 83 per cent, accounted for mostly inability to recover term credit. The loan recovery rate of RD-12, which is one of the successful microcredit projects, has been above 97 per cent.

71. In 1994, CIDA and GOB saw the need to move the project toward sustainability and agreed to:

- a) Apply the interest generated from loans towards the RD-12's capital and operating budget;

- b) Reinvest a portion of the members' savings in the revolving loan fund;
- c) Allow the project to establish interest rate comparable to the market; and
- d) Move away from cooperative structure.

72. Accordingly, attempts are being made to convert the RD-12 into an autonomous non-banking financial institution called Rural Bittahin (poor) Programme with the object of establishing it as an autonomous, sustainable and financially self-sufficient and non-profit entity dedicated to service the poor and the disadvantaged. Under the Ministry of Youth and Sports micro-credit project called 'Thana Resource Development and Employment Project (TRDEP)' was initiated in 1987, with the objective of assisting people without assets or land in rural areas. The unique approach of TRDEP is its formation of groups of five members from the same families. Borrowers can renew loans up to three times. As on December 1997, a total credit amount of Tk. 1.4 billion was disbursed to 211,010 members and repayment rate is 83%.

## **B. India**

73. As on March 1996, the banking sector in India included some 27 nationalized commercial banks, 35 domestic private commercial banks and 29 foreign banks, with a combined total of nearly 33,000 branches. The Reserve Bank of India (RBI) has encouraged the establishment of Regional Rural Banks (RRBs) to rationalize commercial bank lending to priority areas and synchronize the delivery of loans to areas under Service Area Approach. However, there is limited response from the banking institutions as prudential banking norms (high reserve requirements and liquidity ratios), continued to reduce credit resources that they could make available for on-lending, and interest rate ceilings discouraged them from making available their scarce credit resources to small borrowers. Most of the institutions working directly among the poor in India and offering semi-formal sources of microcredit are relatively small NGOs providing microfinance services. MFIs face virtually no competition from the formal sector because the formal sector does not have direct programme for the poor. The traditional sources of informal credit continue to be the major source of microfinance for the assetless poor owing to the limited outreach and concentration of MFIs in selected areas.

74. Developing standards for self-regulation requires an effective apex body. An attempt is being made to establish such a body. The proposed apex body, the All India Association of Micro Enterprises Development (AIAMED) Network was registered as a trust under the Indian Trusts Act in February 1997. Its vision is to make micro-enterprise development/micro-finance a significant national strategy for enabling the poor to become self-employed and contribute with dignity to national building. Major activities of AIAMED are expected to include designing and conducting a national micro-finance survey, training MFIs, sharing information, developing and promoting micro-finance standards, and policy dialogue and advocacy.

### **1. *Integrated Rural Development Programme (IRDP)***

#### **a. Origin and background**

75. The IRDP is by far the largest microfinance programme in India. The scheme involves the provision of credit by banks, with a cash subsidy provided to borrowers by the government. Beneficiaries are selected by the village assembly on the basis of a survey by local officials of households below the poverty line, and are then screened by the banks. It is designed to assist the poorest of the poor with household incomes below Rs. 11,000 per year, with reservations for scheduled castes and tribes, women and the physically handicapped. Priority is also given to the families belonging to the assignees of ceiling surplus land, women-headed households, freed bonded laborers and those who accept the small family norm.

## **b. Methodology**

76. There is no specific interest rate set under the programme, but where loans are made by commercial banks they are subject to the general 12 per cent ceiling for small loans. The maximum loan under the IRDP is Rs. 25,000, with the average loan size in 1995-96 around Rs. 8,150. The repayment period is three years. Lending by banks under the IRDP, along with other lending to priority sectors, is eligible for refinancing from NABARD. Between 20 and 33 per cent of NABARD's annual refinancing has been disbursed for refinancing IRDP. The cash subsidy is equal to 25 per cent of the total cost of the project for small farmers, 33.3 per cent for agricultural farmers, marginal farmers and rural artisans, and 50 per cent for schedule castes and tribes and the physically handicapped.

## **c. Socio-economic Impact**

77. As on August 1996, over 49 million loans had been advanced under the programme since its beginning in 1978. The banks had disbursed credit of around Rs. 166 billion and the direct budgetary cost to government had been around Rs. 105 billion. In recent years, between 2 and 2.5 million households have been assisted each year. Numerous evaluation studies have shown that the IRDP has not met its objectives. For instance, the Interim Report of the Expert Committee on the IRDP, constituted by the Reserve Bank (1995), found the following shortcomings:

- (i) There was inappropriate identification of borrowers, with the subsidies often being captured by households, which are better off.
- (ii) The provision of the subsidy at the beginning of the loan had caused leakage and malpractice, such as encouraging beneficiaries to dispose of the assets purchased with the loan and simply pocket the subsidy.
- (iii) Repayment rates were very low, with the cumulative repayment rate having declined to 30.9 per cent by end-June 1993.

78. It should also be noted that the programme focuses exclusively on credit, rather than on savings. Moreover, given the nature of the programme and the very low repayment rates, it operates essentially as a grant rather than as a mechanism to provide financial services to poor households over an extended period of time.

79. The government has devoted a great deal of resources to the IRDP, both directly through the budget and through refinancing loans made under the programme. But the programme appears to have contributed relatively little in terms of providing financial services to the poor on an ongoing basis. Recently, some changes have been made to the operation of the scheme, in response to the report of the Expert Committee. Most significantly, the government subsidy element has been made back-ended, rather than being received at the commencement of the loan. It remains to be seen to what extent these changes will lead to an improvement in the performance of the programme. Nevertheless, it is fair to say that most government micro-finance programmes implemented through commercial banks have been unsuccessful. Most banks have not made the thoroughgoing changes in organizational design and financial technologies that are necessary to operate successful micro-finance programmes. Moreover, participation in government micro-finance programmes such as the IRDP, which is seen as marginal to their overall operations, and where some of the losses are borne by government, is unlikely to induce them to make these changes.

## **2. National Bank for Agriculture and Rural Development (NABARD):**

### **a. Origin and background**

80. In order to promote agricultural and off-farm rural credit, the Reserve Bank of India (RBI) established the National Bank for Agriculture and Rural Development (NABARD) in 1982. It has now become the apex bank for rural credit that oversees the functioning of the cooperative sector, including the State Cooperative Banks (SCBs). NABARD has provided considerable support to microfinance. In 1992 it launched a pilot project for linking Self-Help-Groups (SHGs) to banks. The project has now moved beyond pilot phase and become a full programme of the bank. The project objectives are as follows:

- (i) To evolve supplementary credit strategies for meeting the credit needs of the poor by combining the flexibility, sensitivity and responsiveness of the informal credit system with the technical and administrative capabilities and financial resources of the banks.
- (ii) To build mutual trust and confidence between the bankers and the rural poor.
- (iii) To encourage banking activity, on the thrift as well as credit side, in a segment of the population that the formal financial institutions usually find difficult to reach.
- (iv) To improve the flow of credit to the rural poor, with reduced transaction cost both for the financial bank and the borrower.

### **b. Methodology**

81. The main features of the programme are as follows:

- (i) The banks extend loans to SHGs, either directly or through NGOs. In around 94 per cent of cases, the SHGs have been initiated and promoted by NGOs. In around two-thirds of these cases the NGOs have acted as non-financial intermediaries, and the loan contract has been between the bank and SHG. This is NABARD's preferred model. In around one-third of cases, the NGOs have acted as financial intermediaries, and have borrowed from banks and on lent to the SHGs. NABARD, however, has sought to discourage this model.
- (ii) The banks lend at an interest rate of 10.5 per cent, if lending through an NGO, or at 12 per cent if lending directly to an SHG. Where the bank lends to an NGO, the NGO on-lends to SHGs at 12 per cent. The banks receive refinancing from NABARD at 6.5 per cent.
- (iii) Loans from banks to NGOs and SHGs are generally for three years, but loans from SHGs to members are flexible, with terms determined by the members. SHGs normally charge interest rates of between 24 and 36 per cent.

82. NABARD has set out a number of criteria for banks and NGOs to use in selecting SHGs. A group should have between 10 and 20 members of homogeneous background. It should have been in active existence for at least six months, and should have successfully undertaken savings and credit operations from its own resources. It should maintain proper accounts and records. The amount of credit given by the bank should be in proportion to the savings of the group. NABARD also require that the group should prepare a simple credit plan for its members, and the group as a whole, and submit this to the bank. The documentation to be submitted by the group to the bank is decided by the bank, but should be simple and kept to a minimum.

83. In April 1996, the Reserve Bank issued a circular to all commercial banks endorsing NABARD's operational guidelines, and advising the banks to initiate necessary action to step up their credit to the rural poor by extensively utilizing the SHG route. The circular pointed to a number of advantages of the linkage approach, including reduced transaction costs, high repayment rates and gradual improvements in incomes for SHG members. The circular also included lending under the programme as an additional segment of lending to the weaker sections under the priority-sector lending requirements, irrespective of the purposes for which loans are used. It also encouraged banks to identify branches having potential for linkages, and to provide necessary support services to such branches. Under the NABARD linkage programme, the Reserve Bank has encouraged banks not to seek physical collateral on micro-finance loans to self-help groups (SHGs), but to rely on group guarantees and peer pressure. This has encouraged banks to become involved in the programme and provided a boost to micro-finance.

### **c. Socio-economic impact**

84. As of March 1997, a total of 8,546 SHGs, with a total membership of more than 150,000, had been linked to banks. Banks had lent Rs. 111 million to these groups, and had received refinancing from NABARD of Rs. 103 million. Twenty-six (26) state commercial banks, two private commercial banks, 67 regional rural banks, seven cooperative banks and 166 NGOs had been involved in the programme. Besides providing refinancing, NABARD has also supported linkages between banks and SHGs in a variety of other ways. For instance, it has funded exposure and training to commercial bank staff to enable them to understand the programme and the advantages that it offers to banks. Training is normally provided by NGOs and training institutes. By September 1996, around 2,200 bank officers had received training and exposure.

85. The programme is clearly a very positive initiative, with an active programme for supporting linkages between banks and specialized MFIs. The linkage approach offers a number of advantages as a model for the delivery of microfinance services. First, it combines the financial strength and resources of the formal banking system with the advantages of community-based MFIs in reaching the poor. Second, it provides specialized MFIs with what is potentially an almost unlimited source of funds with which to expand their operations. Third, it provides for an integrated financial system, rather than separate financial systems for poor and non-poor clients.

86. Nevertheless, the programme as currently implemented suffers from a number of drawbacks that hinder its expansion. Most importantly, it is not sustainable in its current form. In particular, the mark-ups do not provide anywhere near a sufficient margin for NGOs to recover the costs of forming and motivating SHGs. Where NGOs act as non-financial intermediaries, banks receive refinancing from NABARD at 6.5 per cent and lend to SHGs at 12 per cent. Hence, the mark-up between bank and SHG is only 5.5 percentage points. In practice, banks retain this margin and do not reimburse the NGOs for their costs, which in any case are likely to be well above 5.5 percentage points. Where NGOs act as financial intermediaries, the mark-up is only 1.5 percentage points. Hence, the margins available to NGOs under the linkage programme are even less than those available under the programmes operated by RMK and SIDBI, and NGOs are only able to participate in the programme if they can obtain donor funds to subsidize their activities.

87. Clearly, this is a major impediment to the expansion of the programme. The restrictions on the interest rates that both banks and NGOs can charge to SHGs should be removed, which will permit NGOs to recover their costs, and enable the programme to operate on a much more sustainable basis. Where NGOs act as financial intermediaries, they could directly increase the interest rate that they charge SHGs. When NGOs act as non-financial intermediaries, it would enable banks and NGOs to establish a contractual relationship, whereby banks charge a higher interest rate to SHGs and reimburse the NGOs for the costs of promoting the groups.

### **3. *Rashtriya Mahila Kosh (RMK)***

#### **a. Origin and background**

88. The Government of India has provided considerable support to specialized MFIs through the second tier microfinance institutions. Essentially, these institutions channel funds to specialized MFIs at concessional interest rates. The three major second tier institutions are Rashtriya Mahila Kosh (RMK), the Small Industries Development Bank of India (SIDBI) and NABARD. The largest of the three programmes is that operated by RMK, which was established by the government in 1993 with a corpus fund of Rs. 310 million, and is registered as a society. A governing board appointed by the government, consisting of ten government officials and seven representatives from the NGO community manages it. In addition, the general body, which includes all the NGO partner organizations, meets once a year to exchange experiences and advises on policy matters.

#### **b. Methodology**

89. RMK provides loans to NGOs for on-lending to poor women. It also channels funds through women's development corporations and cooperative societies. In most cases, these partner organizations lend to Self-Help Groups (SHGs), although in a small number of cases they lend direct to final borrowers. Loans must be means tested, with borrowers in rural areas required to have a family income of Rs. 11,000 per annum or less, and borrowers in urban areas required to have a family income of Rs. 11,800 or less. Loans must be provided for income-generating activities, to a maximum of Rs. 4,000 for short-term loans (6 to 15 months) and Rs. 6,000 for medium-term loans (2 to 5 years).

90. The interest rate charged by RMK to partner organizations is 8 per cent, and they are required to lend to SHGs at 12 per cent. SHGs must lend to members at no more than the unsecured lending rate charged by state commercial banks, currently 18.75 per cent. Hence, the margin available to partner organizations is only 4 percentage points. However, they are able to obtain some interest rate relief from RMK. If they disburse loans to final borrowers within 30 days of receiving the funds from RMK, they receive relief of 1 per cent of the loan amount. If they repay their loan to RMK on time, they receive relief of a further 0.5 per cent of the loan amount. They are also eligible for a subsidy of 1 per cent of the loan amount for training SHGs. Hence, if they meet these conditions, the effective interest rate from RMK to partner organizations is 5.5 per cent, providing a margin of 6.5 percentage points to the partner organization.

#### **c. Socio-economic impact**

91. By March 1997, RMK had sanctioned loans of Rs. 351 million to 170 NGOs. These credit facilities are expected to benefit 190,000 women. Rs. 205 million had already been disbursed. RMK plans to reach 1 million borrowers during the ninth plan period from 1997 to 2002. The cumulative repayment rate on loans from RMK to partner organizations is currently 95.0 per cent. RMK does not monitor repayment rates on loans by partner to SHGs or individuals. RMK also provides support to microfinance in other ways. It offers interest-free loans to NGOs who are already partners, or who have the potential to become partners for the formation, promotion and development of SHGs. These loans are convertible into grants if certain conditions are fulfilled. It also conducts exposure workshops for NGOs.

92. The model used by RMK, Small Industries Development Bank of India (SIDBI) and National Bank for Agriculture and Rural Development (NABARD), whereby a second tier institution channels funds to specialist MFIs that meet certain criteria, offers a number of advantages. Most importantly, it takes account of the particular strengths that specialist MFIs have in reaching poor borrowers, such as their proximity, trust, commitment, flexibility and

responsiveness. It can also ensure that MFIs face a level playing field, with support available to all MFIs meeting predetermined standards. And it can ensure that MFIs face one set of performance and reporting standards. The data that are available indicate that the three institutions have been quite successful in expanding the outreach of microfinance in a cost-effective manner, with RMK in particular reaching a substantial number of borrowers and achieving reasonably high repayment rates on loans to MFIs. Nevertheless, total outreach of the three programmes is approximately 200,000.



## V. CASE STUDIES IN SOME LATIN AMERICAN COUNTRIES

### A. Costa Rica

93. The case studies commented in this chapter are all-rural in character.<sup>2</sup> They have been selected because of the interesting lessons they provide, and because of their promising performance in terms of outreach and sustainability. Practically all of them are still struggling with an adequate balance between outreach and sustainability objectives, which is a symptom of the fact that in the area of rural finance considerable research and development (R&D) efforts are still necessary to develop adapted methods of micro-finance.

94. The cases may be located within the same typology used earlier.

Specialisation → Ownership	Specialised MFIs		Other institutions with MF activities
	Second-tier	First-tier	
State	TROPISEC, NIC		
Private For profit		CREDOSA, CR	
Private Not-for-profit	FINCA-CR	FDL-Nitlapán	
Co-operative	FACACH	Village banks FINCA-CR BCCSD-PRODESSA, NIC	

95. The institutions selected have to be analysed in their political and economic context and their objectives and target group. Of course, in many respects the institutions differ from each other, but in a certain way they used some basic instruments to become successful.

#### 1. *Fundación Integral Campesina of Costa Rica (FINCA-CR)*

##### a. Origin and background

96. The *Fundación Integral Campesina of Costa Rica (FINCA-CR)* is an NGO dedicated to supporting small producers in rural areas of Costa Rica. As a second-tier organisation, FINCA-CR provides technical and financial services to village banks that were founded with the assistance of FINCA-CR. The village banks themselves are autonomous organisations operating in rural areas, established to offer financial services (savings and credit). Founded in 1984, FINCA Costa Rica is one of the oldest village banking institutions in the region. The model was adapted of the village-banking programme of USAID in Bolivia, but modified to the Costa Rican rural context. Throughout its history, the programme changed its methodology to meet contextual realities and to strive for financial self-sufficiency.

##### b. Methodology

97. In 1984, thirty village banks were formed in rural areas, including the southern area that is one of the poorest of Costa Rica. In the beginning loans and repayments were in kind (grains) with an average of US\$ 60 per village bank member. The loan to the village bank was on a 5-year term, while the loans to the members had a term of one year. No official interest rate was charged, but a saving of 20 percent was required to expand the credit portfolio. The first

<sup>2</sup> As said in the introduction, this is due to the experience and documentation of the authors.

modification was to eliminate lending and payment in kind. Secondly, credits were synchronised to the agricultural cycle, and thirdly, FINCA-CR encouraged a better selection of members and screening through increased training at the village level.

98. During the years new modifications were introduced based on the experience. A three-level village bank classification was introduced. Banks were classified as either at Stage A (new or poor performance; 60%), B (good performance; 35%) or C (strong performance; 5%). This classification allowed for a better estimation of the demand, and differentiated the average loan size; US\$75 in 1985 to US\$217 for stage A banks and US\$1,630 for B and C stage banks in 1990. Following a grant of US\$85,000 by IDB in 1989 for technical assistance, the group lending methodology was abandoned and individual loans were introduced. This made it possible to analyse the credit performance on individual level, however it increased the transaction costs and took away the social/peer pressure. At the same time, to hold the individual and the village bank accountable for their loans, and to make solid claims in case of default, the village banks had to legalise their status.

99. FINCA-CR gradually became more and more aware of the financial sustainability. Real interest rates were increased to a positive level (between 1991 and 1995 the real interest was oscillating between 3 and 18 percent). An important and more recent change was the introduction of a new legal status of the village banks. Previously, village banks were associations on non-profit base, with one vote for each member. In recent years FINCA-CR has promoted to change the legal status of the banks in business associations ("Sociedades Anónimas"), where votes depend on the shares held by the members and credit is based on the number of shares. The average of a share is US\$ 25. The advantage of a business association is that the purchase of shares by members allows for member-ownership of the bank. There are incentives for the members who have a greater share to manage the bank carefully. Legally it is easier to prosecute the group in case of default. Also it allows groups to negotiate with other financial intermediaries. Nevertheless, there exists the risk of monopolising the bank by the better-off producers. Shares can be sold only to other members.

100. To promote the creation of new village banks, FINCA-CR has a team of field workers. Village banks are created through the initiative of FINCA-CR or communities themselves who invite FINCA-CR to work with them. The community has to be rural with a reasonable degree of accessibility, with low to medium incomes and sufficient member candidate for the village bank. The new village banks have to decide on their own about internal rules such as meeting times, penalties and loan guarantees. An important activity of FINCA-CR is the training of clients related to the management of the bank. Training in bookkeeping is minimal since banks are using external accountants to produce the monthly financial statements and other financial data.

101. An important issue in the FINCA-CR methodology is the emphasis on savings. The village banks collect their own savings and deposit them in commercial banks or lend them on to their members. In the beginning FINCA-CR introduced compulsory savings of 10 percent of the loan size. However this did not work out properly and was seen by the members as an obstacle for the access to loans. Currently there are four basic types of savings instruments used by the village banks: sight and term deposits, capital certificates in the case of village banks with the legal status of non-profit associations and shares in the village banks that exist as business associations. In a sample of 12 village banks, Paxton (ibid.) found that 29 percent of the village banks funds were coming from local sources (deposits and capital shares), while the remaining 71% were external institutional funds: 49 percent from FINCA-CR, and 22 percent from other institutions. The bulk of local resources were mobilised in equity shares (an average of US 150 per borrowing member). Paxton also observed that the voluntary savings have grown in importance in many village banks.

102. The average village bank has 26 members. There is, however much variability, with the smallest bank having eight members and the largest having 239. Very few banks have more than 50 members. As a second-tier organisation, FINCA-CR functions as an intermediary. The

nominal interest rate charged by FINCA-CR was about 22 percent in 1997 (10 percent in real terms) with a term of one year for A banks and four years for B banks. Collateral requirements depend on internal regulations within the banks. Most banks use co-signings or chattel mortgage. Joint liability is not in use in most of the village banks. The majority of loans are used for agricultural activities. The nominal interest charged by the village bank to its members is about 25%, while the average term is 19 months.

103. For educational purposes and donor requirements, FINCA-CR makes the village banks separate the portfolio financed with institutional funds from the portfolio financed with local resources (deposits, capital shares). Interestingly enough, the use of the so-called “internal fund”, the resources of deposits and capital, differs a lot from the use of the institutional loans, in terms of conditions, amounts and allocation. The average term is 9 months, with an average amount of US 580. The interest rate is 4 percent above the FINCA-CR fund, and credits are mostly used for consumption. The advantage for the borrowers to use the credit of the internal fund is the lower transaction costs, relatively little paperwork is required.

104. In a few village banks, some or all of the members have developed collective projects aimed at generating profits. FINCA-CR has financed some of these projects, principally in agriculture, livestock and trade. The importance of these collective investments however is limited and the results at least ambiguous. FINCA-CR also has developed a broad network of collaborating institutions. More than 50 private firms are giving economic, technical, or marketing assistance to specific village banks. In this way FINCA-CR provides its clients with non-financial assistance without having to pay for it directly.

### **c. Socio-economic impact**

105. Of the 228 village banks that have been created since the foundation of FINCA-CR, 171 were active by the end of 1995, with a total number of 7250 members and a credit portfolio of US\$ 1,1 million. Most banks are concentrated in two regions of Costa Rica, which allowed FINCA-CR to operate with lower costs than would have been possible if there were greater dispersion. Most of the village bank failures occurred in early years in poor areas with a history of government grants. The average bank in 1995 had 32 members, including non-borrowers as net savers. The average loan size is relatively large, of about US\$1006, 38 percent of GDP per capita in 1995. The minimum loan size in the same year was US\$250 and a maximum of US\$2565. The large loan size is influenced through the economical situation of Costa Rica. Costa Rica has a relatively strong and stable economy with a relative developed legal system and a high educational level.

106. The repayment rate is above 92%. However, a frequently used instrument has been to reschedule loans (extension of terms) when clients were confronted with repayment problems. The portfolio at risk was 18.3% in the same year. During the last years, FINCA-CR reached operational and financial self-sufficiency. Nevertheless the financial costs as a percentage of the outstanding loan portfolio have increased through the growing dependence on commercial funds, but this resulted in a lower subsidy dependence index.

## **2. “Créditos de Osa” programme (CREDOSA), Costa Rica**

### **a. Origin and background**

107. The “Créditos de Osa” programme (CREDOSA) was founded in 1989 with the assistance of the German and Costa Rican governments after the hurricane “Joan”. The objective of the project was to finance the construction of new houses, buying land and to establish a credit fund in the area of Osa in the south of Costa Rica. The Costa Rican counterpart was the public institute of social action (IMAS), and on the German side GTZ and IPC administered the financial and technical assistance. A local commercial bank was

contracted as a trustee to administrate the credit fund. The bank charged a fee of 3% per year on the credit portfolio.

108. The main economic activity in the Osa district is agricultural. Through the characteristic climate (warm and humid) only traditional crops can be sowed (grains, yams and banana or pineapple). Another important activity is livestock husbandry. Small farmers, with less than 10 hectares of property, dominate the agrarian structure. Other economic activities, like trade and services, are limited. Population density is low and concentrated in small villages. The distance between villages varies between 10 to 130 kilometres. The district capital is Palmar Norte, with a population of 26000.

## **b. Methodology**

109. CREDOSA has two offices in the district. One of the financial objectives was to diversify the loans between the economic sectors, to develop a variety of economic activities and to reduce the portfolio risk. The first loans were only given to the less risky activities: trade and services in the district capital Palmar Norte. Nevertheless, through the dominance of the agricultural sector, about 60% of the loan contracts were concentrated in this sector and 32% for commercial and services.<sup>3</sup> This concentration in agriculture with the implicit risks involved made CREDOSA try to increase the participation of the other sectors and limit the expansion of the agricultural sector in their credit portfolio.

110. An interesting feature is the method by which CREDOSA developed its portfolio in the agricultural sector, being aware of the risks involved. CREDOSA made use of the information provided by existing clients (traders of agricultural products who knew the area and the people) and with that information selected two zones to start to finance agricultural activities. Later on, new zones were selected, always starting with a small group of farmers (20 to 30). In the following year they made a selection of the best borrowers, and excluded the bad ones. With the help of the good borrowers and middlemen they selected new clients to expand the credit fund in each zone. The use of local information in the selection of new clients is one of the reasons for the good repayment rate.

111. After a couple of years CREDOSA was confronted with a saturation of the credit market in Palmar Norte. A demand survey was carried out the smaller towns of the district. Based on the survey, two small towns were selected and the new loans were given initially to the trade and service sector. In the case of the agricultural sector, the main problem was to set up a system to reach the disperse clients in a huge area and the possibility to recover the repayment quotas bi-weekly. As a probable solution for this problem, CREDOSA started a pilot project of a mobile bank for a period of eight months, to find out the cheapest routes and to establish a break-even number of clients (an estimation of 35 persons for one route). Further on, they defined for those producers who are living in the most isolated areas that they should establish small groups of at least 4 persons to reduce the transport costs per loan.

112. In one trip, two credit officers recover about 40 loans and can fill out 12 new loan applications. The disadvantages of the mobile system are the lack of time to recover all credits and the security aspect. For these two reasons they changed the frequency of the trips from every two weeks to every week: in the first week they recover the loans and make list of potential new loans; and in the second week they fill out the application papers. However, the mobile bank was not successful in all circumstances because people prefer to pay their credits in permanent offices and also the maximum amount per loan of US\$ 1600 was too small in an area where the main crop is coffee. The monitoring of the credits is minimal. Old clients, defined as those persons who have cancelled at least two credits without problems, are rarely visited. New clients are visited once to check the credit application, and twice during the production cycle. In the case of payment problems, the visit frequency is increased.

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<sup>3</sup> These data refer to 7055 loan contracts between December 1991 and June 1995.

113. In 1994, the CREDOSA credit portfolio was sold to a commercial bank in Costa Rica. This happened at a moment when the financial reform was being implemented and the private banks were allowed access to the short-term deposit market and the discount facilities of the Central Bank. The condition was that private banks should demonstrate investments in (rural) small-scale production, either by establishing at least four branch offices in rural areas, or by investing a certain percentage of their portfolio in small-scale production. The Banco del Comercio chose to buy the CREDOSA portfolio in order to fulfil a part of these conditions. Most loans in CREDOSA were short-term with initially small amounts, and which are increased in following loans. The average loan amount in 1995 was US\$1400 on an average term of 6 months.

### **c. Performance and impact**

114. In June 1995, the credit portfolio was of about US\$ 700,000, distributed among 4700 credit loans. The repayment rate was about 95%. With the introduction of mobile banks CREDOSA is able to reach a group of clients in geographically dispersed areas. CREDOSA had not yet reached its break-even point, basically because of its high operational costs that was 20-25% of the outstanding balances.

## **B. Case studies in Nicaragua**

### **1. Banco de Crédito Campesino de San Dionisio (BCCSD), Nicaragua**

#### **a. Origin and background**

115. San Dionisio is a rural municipality in the northern department of Matagalpa, Nicaragua, in a valley where maize production has a comparative advantage. The Banco de Crédito Campesino (Peasant Credit Bank) de San Dionisio (BCCSD) is one out of two associations created by the Union of Organised Peasants (UCOSD).<sup>4</sup> The BCCSD was created in 1992 with support from a private organisation (PRODESSA), with the purpose to stimulate agriculture and the economic situation in general by extending financial services to small producers. Those producers have areas of about 10 to 15 hectares as maximum and a production system focused on basic cereals, coffee and cattle breeding.

116. The “bank” has its own legal status and is financially autonomous. One professional and a board of local peasant leaders manage it. The NGO PRODESSA plays an advisory role, for which the bank has to pay.

#### **b. Methodology**

117. BCCSD has a two-tier structure. At the central level is the “bank”, which administrates and manages the credit portfolio and receives the loan applications. Then there is the credit committee with presence in each of the 18 communities of the valley and producer associations. The function of the local credit committees is to select the credit applications of the credit groups in the community, including the repayment. Credit groups include 5 to 7 members and are auto selected. Members are obligated to follow each year a credit training of two days, in which the conditions of the loans are explained in detail. The credit committee gives the course. Local supervisors, mostly sons of producers, who are paid by the bank, support the committee. Another task of the supervisors is the monitoring of credit loans by visiting the borrowers. Supervisors are paid by task and do not have a fixed wage. The credit portfolio is concentrated

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<sup>4</sup> The BCCSD is not a bank in the legal sense, but rather a farmer-managed credit union. In Nicaragua the image of co-operative organisation has been damaged in the Sandinista period, and accordingly many farmers organisations try to avoid the term “co-operative” in their names.

in the agricultural sector. To reduce the costs of the bank, the credit design is built around the agricultural production cycle.

118. Group members are required to buy shares of 20-30 percent of the value of the loan in order to qualify for their first loan (the value of one share is US\$ 8). The philosophy behind the shares is that clients demonstrate their seriousness about participating in the bank and show an ability to manage their finance. The real interest rates are differentiated according to the kind of activity: 19% in dollars for short-term loans (less than 1 year), and 15% for medium-term loans (1 until 5 years).<sup>5</sup> The relatively high interests charged are used to cover the administration costs (5.5%), to establish a reserve fund (11.5%) and a social fund for emergencies (2%). In the case of long-term loans, 6.5% is charged for the reserve fund, because coffee and livestock husbandries are less risky than annual crops.

119. The loans are secured with co-signing by the group and chattel mortgage (a physical asset). Also a two-step peer pressure scheme is used. Firstly, groups only can obtain new credits when all members have paid or up-to-date with their loans. Secondly, if one group is in default, all the other groups in the same community is excluded from medium-term lending and can only obtain new short-term loans. Not only groups of individual producers have access to credit; the bank has also financed producer associations like a tomato processing plant and a grain bank. The latter one is another programme of the UCOSD.<sup>6</sup>

### **c. Socio-economic Impact**

120. In the first year, 1992, about 460 credit loans were given to small-scale producers in 18 communities in the valley. There exists a high degree of participation in the organisational structure of the Credit Bank. The bank is owned and operated by its members who are also the beneficiaries or clients. The operational costs are low and management expenses are negligible; the only salary is paid to an administrator. One of the limitations of the Credit bank is the lack of diversification of the portfolio. The Credit Bank lends only to the agricultural sector, and most clients are cultivating basic cereals.

## **2. FONDECA-TROPISEC, Nicaragua**

### **a. Origin and background**

121. In 1994/95, a total of 14 new rural credit unions were founded in the aftermath of two large IRD projects in the northern departments of Estelí, Madriz and Las Segovias, funded by IFAD and the European Union respectively. The credit unions were created on the basis of producer groups that had participated in the extension and credit activities of these projects, which is normally a very fragile and opportunistic basis for local organisation. The successor project, TROPISEC, funded by IFAD and EU together, was given the task to consolidate these artificial credit unions into local financial intermediaries.

### **b. Methodology**

122. TROPISEC established a second-tier loan fund (FONDECA) for local intermediaries, including the newly founded credit unions as potential clients, but with the possibility to expand the portfolio towards other types of local intermediaries (NGOs, marketing co-operatives etc.).

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<sup>5</sup> In the Nicaraguan financial context credit contracts are firm with fixed real interest rates. An additional interest rate has to be paid to cover the devaluation of the local currency. In 1996 the nominal interest rate for grains was 40%.

<sup>6</sup> The grain bank was established in 1990 with a loan of PRODESSA. The objective of this Grain Bank is the marketing of grains and the sale of agricultural inputs. Producers can obtain credit in kind (fertiliser and improved seed) if they are members and commercialise their grain through the bank. The Credit Bank finances the sale of agricultural inputs, the real interest to be paid by the Grain Bank is 5 percent per month.

TROPISSEC established a strategic alliance with the national micro-enterprise institute (PAMIC), that was setting up a support programme for the expansion of rural financial services, in coordination with several donor organisations. The PAMIC support programme was inspired on accumulated frustration among the donors about the meagre results in rural credit initiatives, and its objective was the consolidation of local financial intermediaries through technical assistance and the creation of an appropriate enabling environment. PAMIC supported the credit unions with training and technical assistance, and helped the credit unions in setting up their bookkeeping systems, improving the quality and timeliness of their financial reports, drafting internal procedures, training the leaders, etc. Later on the credit unions were assisted with software for accounting and portfolio monitoring, and with strategic planning. The TROPISSEC project provided initial and diminishing subsidies to the credit unions to finance part of the operating costs (salary expenses, office supplies, and investments in vault and motor cycle), conditional upon compliance with the technical recommendations.

123. The credit unions that responded positively to the technical assistance were given access to second-tier loans, at a 12% real interest rate to the credit union. Twelve of the fourteen credit unions are currently borrowers of the second-tier fund, with total balances per credit union averaging between US\$ 52 and US\$ 642 per member. Repayment at the second-tier level has been good, with some loans falling into arrears but being paid afterwards. The smallest credit union has 152 members and the largest 659 (July 1997). The credit unions lending methodology is based upon a participatory screening process, with local credit committees operating in each rural community and a central credit committee functioning under direct authority of the member's assembly. The local credit committee is the first screening device and the central credit committee, advised by the credit unions manager (individual repayment reports), takes the final decision. The local credit committees also perform a support function in recovering loans. Initially the credit unions worked with joint liability as their main guarantee. Their origin as donor-induced organisations, however, made this type of social collateral dysfunctional and the credit unions were forced to back their loans with more traditional types of collateral: land property documents for loans above US\$ 1000, and mobile collateral (cattle, electronic devices like radios, frigidaires etc.). The joint liability continued functioning in a few credit unions, as a screening device rather than a substitute for collateral.

124. The loans are disbursed and paid in cash and there is no technical supervision of the investments made by the final borrowers. The credit unions are free to determine their interest rates to the final borrower, which vary between 18% in dollars for agriculture and 36% in dollars for trade and industry. Some of the stronger credit unions are planning to establish branch offices in a neighbour municipality, as a part of their growth plans. Several credit unions have started to offer savings services to their members.

### **c. Socio-economic impact**

125. Halfway into 1998 the credit unions reached almost 5000 members, principally with credit but increasingly with savings too. The credit unions have grown very rapidly, a process induced by the availability of resources from the second-tier fund. They have paid their debts reasonably on time and have been able to diversify their credit portfolio, although the potential to diversify for each credit union is obviously limited by local circumstances (soils, microclimate). The major part of their credit portfolio is still invested in agriculture and livestock, although the loans to non-agricultural sectors are growing: most credit unions are highly concentrated in agriculture and livestock (>90%), while others reach 23-40% in trade and services. This pattern of diversification of the portfolio is contrary to what most MFIs do: to start with urban finance and then to "trickle down" to agriculture. This is largely due to the fact that the founders of the credit unions are mostly farmers.

126. The financial performance of the credit unions is still ambiguous. The interest margin is too low to cover the operating costs, the administrative costs in some of the credit unions is too high to be sustainable (over 15% of the average portfolio), and the default rate is only

unambiguously low in a minority of credit unions. It took them several years to get a proper insight in their financial performance, with administrative systems able to provide timely and transparent information. The capital-asset ratios are far too low to sustain any adversity in the future, and are also being eroded under pressure of operating losses. The risk is still strongly present that these credit unions deform into donor-induced “hydrocephalic” organisations, channelling credit to target groups.

127. Still, there are valid arguments to consider the promising elements in this experience. First of all, the elements necessary for a consistent enabling environment are gradually falling into place. At the national level a benchmarking system for non-bank MFIs is being developed (administered by PAMIC), and is closely linked to the Superintendents’ regulation system. The owners and management of the second-tier fund are also growing aware of the necessity to dossify funding according to the financial performance of the credit unions, and they are prepared to channel funds away from the ill-performing credit unions towards better-performing NGOs in the region. These elements pave the way for a more balanced growth path of the credit unions, as they impose stricter discipline on their entrepreneurial behaviour.

128. Another promising element is the capacity of the credit unions to adapt their financial products and investment portfolio to the local situation. The fact that most of their members are farmers will keep them on track in adapting financial technology to the needs of agriculture. As an example, the adaptation of the guarantee regime was an interaction between a more demanding second-tier fund and the capacity of the credit unions to adapt their modus operandi. The combination of a demanding second-tier fund, imposing strict rules on financial performance, with credit unions deeply rooted in the countryside, may act as a catalyzing force for innovation, and that is necessary in the less advanced area of rural microfinance.

## **C. Case studies in Honduras**

### **1. Federation of Savings and Credit Co-operatives of Honduras (FACACH)**

#### **a. Origin and background**

129. European immigrants, the Catholic Church and the Alliance motivated the credit union movement in Latin America for Progress through USAID. In Honduras the movement started in the 1960s and was mainly based upon savings mobilisation. Since 1975, the credit unions received massive and cheap external credits directed towards specific target groups and objectives. This led to a relaxation of the credit discipline and a negligence of the mobilisation of local resources. Halfway into the 1980s, USAID started a strengthening project for co-operative organisations, with the objective of reinforcing the entrepreneurial capacity of the credit unions.

#### **b. Methodology**

130. Although there are significant differences in the methods of each credit union, the basic credit products are very similar. Most credit unions distinguish, three types of credits: automatic credits up to 80-90% of the total deposits of the member, guarantors credit guaranteed with a co-signer and up to 3 times the value of deposits of the borrower, and mortgage credit for amounts over US\$ 1500-2000. New members have to save during at least 3-6 months before they can apply for a loan. This system ensures that all members are savers, but only part of the members are also borrowers (generally between one to two-thirds). Typically the credit unions require their members to pay annual capital contributions, according to the co-operative law (US\$ 10), and to subscribe to a monthly savings programme. The capital contributions can be withdrawn when the member finishes his membership, which makes the credit unions eventually vulnerable to depositors’ rushes. The interest rates of the credit unions are considerably lower

than the private bank interest rates. The difference may reach more than 10 points and is explained in part through lower deposit rates and lower operational costs, but also by the absence of low-paying reserve requirements.

131. The credit unions have generally abandoned flexible guarantee mechanisms that were previously in place. In the previous decades the credit unions used to accept mobile collateral for their loans, but the repayment performance on that type of loans was disappointingly low. Still now, the mortgage credits demonstrate a better repayment performance than the guarantors credits and that confirms the conviction of most credit union managers. In the present decade, the policy of the credit unions movement has been to expand its network through the establishment of branch offices of existing co-operatives, rather than setting up new credit unions. The reason is that the investment in human and institutional capital is very expensive and difficult and the probability of success is too low for newly starting credit unions.

### **c. Socio-economic impact**

132. In Honduras, more than 100 credit unions exist and most of them (95) are members of the federation FACACH. More than 250,000 members are affiliated to the co-operative credit system and if every member represents a family, that would make 25% of the Honduran households a member! The credit unions differ in size and scope, ranging between 200 and 35,000 members, and between US\$600 and US\$10 million in total assets.

133. The total assets of the credit union movement are about US\$90million, of which US\$75 million is invested in the credit portfolio. The assets are financed largely with savings and term deposits (89%). Mainly member's shares compose the capital, but also a modest capital has been constructed with retained profits. The average size of the loans is about US\$1200, with terms from six months to four years. Housing and trade loans occupy each a quarter of the consolidated portfolio, and consumption loans another 17%. Loans for productive purposes (agriculture, industry) are a minority in the credit unions portfolio, which makes them typical institutions for the wage receiving (low-) middle class.

## **2. *Fundación Covelo network, Honduras***

### **a. Origin and background**

134. The Covelo Foundation was set up in 1984 as an alliance between the industrial employers association (ANDI) and USAID. It started as a programme for technical assistance and training to small entrepreneurs that had borrowed capital from a private agricultural finance corporation. Shortly afterwards the programme shifted its attention to technical assistance for NGOs involved in microenterprise development. In 1993 the foundation started to administer a fund for relending to the NGOs, and thereby transformed itself into a credit intermediary (González-Vega 1998).

### **b. Methodology**

135. As an APEX organisation, the Covelo programme initially involved more than 20 NGOs. But after an adjustment of the eligibility criteria, it reduced its attention to 8 organisations that were considered potentially viable MFIs. The Covelo foundation operates its network with second-tier loans to the NGOs, technical assistance to the NGOs, and a monitoring system on their financial performance. The MFIs that operate successfully are stimulated by an incentive programme, gaining access to subsidised loans; with this programme, Covelo intends to compensate for subsidised loan offers by other institutions to the member NGOs. Covelo in its normal operations offers three loan types to the NGOs: regular loans, overdrafts and lines of credit. By 1997 all participating NGOs had graduated to the credit line modus.

136. Besides its second-tier operations, the Covelo foundation operates a first-tier microcredit portfolio, with the solidarity group methodology. The direct lending service is operated mainly in the popular markets, through branch offices located in the market. Apart from its role in financial intermediation, the Covelo foundation is developing several non-financial services. The foundation is playing a dominant role in the financial NGO lobby that presses for recognition by the supervision authority. The foundation offers itself as an institution to which the monetary authorities can delegate the supervision of the financial NGOs, under a mutually agreed regime of regulation and supervision. For that to happen, a new legislation on the legal status of financial NGOs is indispensable and should clarify the property structure and minimum requirements to be recognised as a financial NGO. A consensus about this aspect however has not yet been reached.

### **c. Socio-economic impact**

137. The variety of activities of the Covelo foundation, ranging from first- and second-tier credit operations to the benchmarking and supervision of financial NGOs and the development of local business centres, is a symptom of the small country syndrome identified by González-Vega (1998). The number of viable first-tier MFIs in Honduras is too limited to make an APEX organisation scale-efficient, and thus the institution is forced to diversify its operations into other areas. Notwithstanding this point, the Covelo system is maybe the most relevant network on microfinance in Honduras, and most advanced in terms of benchmarking and quality control. The Covelo network has achieved an outreach of more than 40,000 clients in 1997, 90% of which are female. The credit portfolio is about US\$5 million, with average loan amounting to around US\$125 per client.

## VI. CONSTRAINTS

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138. The major constraints that have held back the extent to which MF programmes have been able to reach the poor include:

- i. **Motivation:** Executive staff lack vision commitment and missionary zeal. They usually set safe and conservative targets and cannot take bold decisions. Moreover, among the senior staff, especially in the Government-driven programmes, there is paternalism, suspicion and distrust of the poor. They think that poor are responsible for the continuation of their own plight due to their conservative nature, illiteracy and some other traits. This attitude fosters an approach that favours 'Charity' and 'relief' instead of building capacity of the poor for self-reliance and self-help.
- ii. **Loose Targeting:** In many MF programmes a substantial number of the clients served are above poverty line. Therefore, the resources targeted for the poor are lost through leakage to households that are not poor or near poor. MF programmes should pay more attention to targeting and quality control procedures to ensure that the poorest of the poor are being served.
- iii. **Financially Unsustainable Practices:** During establishment of the MFI adequate attention is not given to the business practices which is essential to make it financially sustainable in a reasonable time-frame. Due to pressure to assist the poor to meet their immediate basic needs, some MFIs take the easy way out and do not begin with a business plan. Also MFIs starting with donor grants or subsidized funds tend to be lax and fail to consider the need for sustainability strategy from the very outset.
- iv. **Inadequate Resource Mobilization:** Some of the MFIs do not pay adequate attention or identify appropriate resource mobilization strategies thus resulting in:
  - a) savings mobilization being well below potential;
  - b) the nature of supports sought from the financial supporters are not based on the outreach goals designed to achieve financial viability or target growth rated for outreach;
  - c) The approach to outreach is based on and often limited to what donors have been prepared to fund with grants.
- v. **Legal Constraints:** The confidence of the borrowers and depositors is difficult to secure when an MFI is unable to assure potential clients that it is acting legally. In addition, the confidence with which the MFI will pursue over large deposit and lending business is influenced by the extent to which senior executives are aware of the potential implications of their lack of legal authority to do so. Without a legal personality as a financial intermediary, MFIs limit the range of financial products they are willing to offer poor households, thereby limiting the extent of their market.
- vi. **Lack of Trained Workforce:** Non-availability of skilled staff to bring financial services to the poor is a major constraint faced by many MFIs. MFIs know what training is needed but lack the resources to invest in the human resource development that is essential for successful outreach.

- vii. **Adverse Effects of Government Policies:** Financial intermediaries to the poor succeed often more easily if they are able to pursue their business in an environment of economic growth and stable prices. In addition, the overheads of doing business can be significantly reduced if the cost of compliance with Government regulations can be minimized or left to industry standard, monitored by a network of MFIs with specific relevance to performance and security offered to depositors and other creditors.

## VII. APPLICABILITY OF THE GRAMEEN EXPERIENCE TO SOME COUNTRIES:

139. The Grameen Bank, an internationally well-known example of formal sector institution providing micro-credit was created in Bangladesh from a research project in 1974. In 1983, it was transformed into a specialized financial institution under a separate government statute, namely the Grameen Bank Ordinance with a mandate to provide financial services to the poor of rural Bangladesh. Grameen's shareholders are its borrowers and the Government. The Bank has paid-up capital of Taka 260 million, a large per cent of which is contributed by member shareholders. By September, 1998 its operations covered 38,809 villages and it had 2.4 million members 94 per cent of whom are women. A total amount of Taka 95.43 billion was extended as credit. The members have saved Taka 7.6 billion in the Grameen Bank's group fund.

140. There are a number of Grameen Bank replications following the methodology developed by the Grameen Bank in Bangladesh, based on individual lending but with group guarantees. Some important components of Grameen Bank's operations are:

- the coupling of savings and credit, all borrowers must deposit weekly savings;
- the ability to maintain a savings discipline determines borrowers credit eligibility, for example, the borrowers pay a certain amount representing a combination of interest and deductions to be divided into the following three parts: a larger percentage of this amount represents the interest on the loan, another is deducted for savings in a group fund and the last part is allocated to an emergency savings fund.

141. Ten NGOs in India are following the Grameen Bank model of micro-credit, the table below provides information on membership, savings and credit of the NGOs following Grameen Replication Projects in India:

**Table-2: Microcredit Status of Selected Grameen Replicators in India. (in US\$)**

NGO Name	No. of Groups	No. of Centers	No. of Branches	No. of Members	No. of Borrowers	Group Savings	Amount Disbursed	Repayment Rate (%)	Data as on
CRESA	280	46	1	1400	896	1284	38878	74	May 98
RDO	2110	322	3	10156	10156	77229	740886	95	July 98
SARS	522	97	3	2610	2357	26700	278087	95	Aug.98
SHARE	2741	738	12	13695	10924	25501	2341997	100	Sep.98
PIDT	48	15	1	240	240	337	5988	90	June98
SPHERE	531	64	5	2648	1312	12708	43446	81	Mar.98
VISA	26	11	1	135	134	359	7305	85	July97
GBUP	208	91	6	1025	592	803	27712	97	Sept.98
SRI	76	23	3	350	376	8986	66616	100	Aug.98
MASSES	32	6	-	160	133	65	12250	83	Aug.98

*Source: Grameen Trust*

142. Table 3 below shows that a number of Grameen replication projects are now being implemented in selected African countries with considerable success. In addition to these grameen replication projects, there are other micro-credit programmes which also have selected components of various micro-credit programmes in Bangladesh, India or Philippines. Sidama Development Programme (SDP) of southern Ethiopia was established in 1994 with the support of the Irish Government. The programme consists of i) education programme, ii) water development, iii) rural road construction, iv) health, v) agriculture and vi) micro-credit. The major elements of the micro-credit programme are: a) poverty focus, b) Gender sensitive, c) participation of the target group and d) sustainability. As of February 1998, there were 377

groups with 7530 members who deposited total savings of 318,000 Birr. Total loan disbursed was 8.6 million Birr. The Association for Social Advancement (ASA), one of the most successful MFIs in Bangladesh, is providing the consultancy service to SDP to develop procedures to achieve a sustainable micro-credit model.

**Table-3 : Status of microcredit programme in Grameen Replication Projects in Selected African Countries. (In US\$)**

Country	Project Name	No. of Groups	No. of Borrowers	Group Savings	Loan Disbursed	Loan Outstanding	Repayment Rate	Information Month/yr
Central African Republic	CAVEC	270	183	2304	7280	6323	58	Mar.98
Cameroon	BERDSCO	27	104	2636	11780	9910	100	Aug.98
Egypt	IPMF	30	39	286	16313	6288	100	Feb.98
Mauritania	APME	109	574	5677	44936	15240	97	Aug.98
Nigeria	LAPO	1556	7055	306856	2478912	1288749	95	Sept.98
	NUSHO	112	575	3940	34881	12074	95	Oct.98
Tanzania	PTF	512	2539	9866	1127529	205790	100	Sept.98
	STF	86	370	2579	56745	21944	93	Sept.98
Togo	SYNORSEC	168	525	859	52823	24524	100	Aug.98
Uganda	NAWOU	27	138	1874	12054	55	89	Sept.98
	PACT	107	502	36672	92050	38374	100	Aug.98
	IRUDP	42	183	2581	15869	12329	100	Sept.98
Zimbabwe	CAP	213	933	10467	741260	410269	60	June.98

**Source: Grameen Trust**

143. International Fund for Agricultural Development (IFAD) projects in Ghana is promoting integrated rural development projects designed to develop the targeted beneficiaries, strengthening the institutional capacity of the participating organizations and infrastructure building in the project areas. A number of rural banks are participating in IFAD-sponsored projects. Under the project the targeted beneficiaries are identified by accredited NGOs, grouped and trained before being tuned on to rural banks for credit. The funds for the credit is released from the Bank of Ghana at a cost much lower than the prevailing rates of interest charged by the rural banks, which guarantee enough margin for the rural banks to meet administrative costs. The project also supports the NGOs to meet their organization and training costs. The project encourages savings as a means of providing security for loan and emphasizes group participation so that peer pressure could be applied for the purposes of loan repayment.

144. The Zimbabwe Women's Finance Trust (ZWFT) was established in 1989 with the objective to assist disadvantaged women to improve their economic status by encouraging and supporting their involvement in micro-enterprise development. ZWFT established a technical training resource center that provides training and guidance in production technology, business development and management skills, credit, marketing, and export promotion. The ZWFT's coordinator received training at BRAC and Grameen Bank. Micro-credit models developed in Bangladesh and India are being replicated with modifications based on the local situation. For instance, Association Caisse Villageoise d'Epargne et de Credit (CAVEC) of Central African Republic is extending its micro-credit programmes not only to poor women, but also to small entrepreneurs and farmers who need credit. Life Above Poverty Organization (LAPO) of Nigeria provides loans designed individually for its rural and urban members, according to their needs.

## VIII. LESSONS LEARNT

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### 1. *Enabling environment*

145. The enabling environment for micro-finance can be looked at from the macro-economic and institutional points of view. Both aspects will be reviewed and commented upon before making some observations on best practices in (rural) micro-finance methodologies.

#### a. **Macro-economic environment**

146. The macro-economic situation in Central America has facilitated the boom of micro-finance activities. The main factors of success may be the availability of donor funding, a macro-economic environment characterised by stabilisation and adjustment measures, and the efforts at financial reform.

147. The massive inflow of donor funding during the 1980s provided funding for an enormous variety of credit-oriented projects. During that period most of the donor-financed credit projects heavily concentrated on achieving outreach targets, rather than seeking financial sustainability. The outreach targets were directed in some cases to the rural middle class that was so important for political stability (cattle and coffee), and in other cases to the tacit but potentially explosive majority of rural and urban poor (subsistence farming, micro-enterprise). It was until the end of the 1980s and beginning of the 1990s that civil war in the region came to an end and the donor agenda changed accordingly. Global donor funding diminished and several donors phased out their activities, thereby shifting the design of their credit initiatives in favour of financial sustainability targets. As a part of the search for financial equilibrium, many credit programme are currently developing strategies of savings mobilisation.

148. On the macro-economic level, the turn of the decade was characterised by strong stabilisation and adjustment measures all over Central America, with Costa Rica being the exception because it already had adopted stabilisation measures since the early 1980s. The monetary contraction restricted the credit portfolios of the supervised banking system and led to the exclusion of certain sectors of borrowers that were marginally profitable for the banks. Normally the most affected sectors were urban and rural middle class, but also the sectors previously covered by the special outreach programme were affected (i.e. land reform co-operatives). These excluded sectors sought to satisfy their credit demand through other channels and thereby constituted a solid market for the non-regulated financial institutions (credit unions, NGOs and the like). As a consequence, we see an expansive growth of the credit unions as can be seen in Honduras and Costa Rica.<sup>7</sup>

149. A third macro-economic factor is the diffusion of financial reform throughout the Central American region. As a consequence, the special discount facilities that Central Banks used to administer for certain productive sectors were closed or at least restructured, thereby affecting the access of banks to resources for special target groups. Additionally, in most countries the public development banks were closed or restructured, reducing their outreach to a meagre 10-20% of their traditional clientele. Finally the financial reform reinforced the position of autonomous regulatory authority, which are beginning to take an interest in the supervision of non-bank credit institutions.

150. The macro-economic situation presented threats as well as opportunities for the micro-finance business. In general, the contraction of the regulated financial sector combined with a generous availability of donor resources, provided a fertile environment for the birth of non-

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<sup>7</sup> In Nicaragua this is not the case, simply because the credit union sector was wiped out during the macromonetary chaos that persisted in the previous decade.

regulated micro-finance initiatives. This made it possible to establish a multitude of credit programmes and to experiment with a variety of credit methodologies. On the other hand, the attitude of donors, governments and executing agencies can hardly be characterised as stimulating for a systematic and efficient process of experimentation. More so, the donors proved to be highly permissive of low-performance, or even senseless credit programmes, and until recently started to worry about the disastrous effects of ill-designed credit interventions on the local financial markets. Until halfway into the 1990s, most MFIs functioned practically without any link with the regulated financial system.

151. More recently, however, we can observe a cautious process in “approaching” the micro-finance business and the formal financial sector. There are three reasons for that. First, the regulatory authorities are growing more aware of their responsibility to supervise NGOs, or credit unions that mobilize savings beyond their own member group. Second, the specialized discount institutions created by the Central Banks (FNI Nicaragua, FONAPROVI Honduras) are under pressure by the civil society to lend resources not only to the regulated institutions (banks), but also to the MFIs that are not being supervised. And third, the MFIs themselves are growing more aware of the necessity of seeking supervision by the regulatory authorities, in order to obtain authorisation for savings mobilisation and access to special discount facilities. This process of “acercamiento” obliges the participants to create a more consistent environment for micro-finance activities, thereby stimulating successful MFIs to expand their operations.

152. It should be mentioned that the “acercamiento” process is urban-biased. As the most solid MFIs as a rule are urban-oriented, there may exist a tendency to develop supervision and regulation instruments on the basis of micro-enterprise credit experiences, rather than promising but immature rural lending schemes. This may have an undesired side effect of limiting further R & D and action-research on credit methodologies for the rural poor.

#### **b. Institutional environment**

153. The most important elements of the institutional environment may be legal and enforcement structures, eligibility and benchmarking procedures and the characteristics of second-tier funding. The provision of financial services in Central America is bound by several weaknesses in the legal enforcement structures. First of all, the property registration systems are known to be incomplete, inefficient and in many cases corruptible<sup>8</sup>. Anyway the only assets that are systematically registered are real estate (land, houses, buildings) and vehicles. That makes mortgaging one of the most secure types of collateral for banks and credit unions, while cars constitute one of the few mobile types of collateral accepted by financial institutions. For micro-entrepreneurs, however, the assets they possess are difficult to execute in the formal economy, basically because there does not exist a unified property registration for them. E.g. land or house without a legal title, animals, radios, TVs, bicycles, tools & machines, etc. Apart from that, the transaction costs of legalising assets and mortgaging them are in most cases prohibitively high in relation to the loan amounts demanded by micro-entrepreneurs.

154. The difficulties with the enforcement of mobile collateral are being recognised by the financial authorities in several countries. It should be mentioned that at least in Honduras and Nicaragua new legislation is being prepared to reinforce the legitimacy and enforceability of mobile collateral (reform proposals to the *Leyes Prendarias*). A last point to be mentioned in the legal context is the weakness of judicial structures. The performance of the courts is subject to severe criticism and mistrust by the public. The problems refer not only to flaws in the judicial procedures (rigidity, slowness, and tractability) but also to defects in the way they are applied (incompetence, corruption).

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<sup>8</sup> Even Costa Rica, where institutional structures are relatively stable and solid compared to its neighbour countries, recently suffered severe problems in the land registration system, that were only discovered during an investigation on fraud in real estate transactions.

155. Another feature of the institutional context is the absence of any coherent bench marking system for non-conventional credit institutions. Although the second-tier funds normally select their clients on the basis of their own criteria of eligibility, in none of the investigated countries does there exist an institution, public nor private, that administers a widely recognised and applied classification system for MFIs. Hence donors or creditors of the MFIs are each forced to develop their own evaluation procedures, with obvious negative effects for their quality and coherence. More recently, however, a growing interest in standardising evaluation and classification systems can be perceived, following the international developments in this area (Micro-credit Summit, CGAP). For the moment, however, Nicaragua is the only country where a public institution (INPYME) is developing a nation-wide qualification system for non-bank credit organisations. In Honduras and Costa Rica such benchmarking systems only exist within the network of limited APEX organisations.

156. Similarly, the area of specialised technical assistance for MFIs is underdeveloped. Technical advice is almost exclusively the domain of private consultants, many of them of foreign nationalities or residence. Industry standards for this area do not exist, and investments in human resources do barely reach beyond specific (second-tier) institutions, or groups of projects that are brought together by a common donor.

157. The area of second-tier funding is being developed gradually. In all Central America several public and private APEX funds exist, some of them operating nationally and a few on a regional level. In their operations with first-tier credit institutions, they suffer the scale and scope of problems that are typical of small countries (cf. González-Vega, 1998). Private APEX funds like ACORDE and Fundación Covelo tend to combine second-tier operations with an own first-tier micro-credit portfolio, in order to gain a minimum scale. In public APEX institutions like FONAPROVI and FNI, second-tier micro-credit operations are combined with their core business of second-tier funding to banks for sectoral loan programmes (not micro-credit).

## **2. Design features**

158. The discussion of design features can be examined in terms of products characteristics, process technologies and institutional aspects.

### **a. Product characteristics**

159. The most visible design features of MFI are its product characteristics: loan amounts, maturity, collateral requirements, interest rates, delivery schemes, savings and deposit services, etc. A common feature of all micro-finance programmes is their search for devices that can substitute for the absence of mortgageable assets among their clients. Their solutions may basically be distinguished in two types.

160. One is the use of alternative collateral, be it mobile collateral, guarantor schemes (individual, group liability, institutional guarantee schemes), or forced savings and/or capital payments. Several micro-finance programmes have excellent experience with mobile collateral, mostly because they succeeded in formulating and applying the collateral contract in such a way that the disappearance of the asset is penalised by criminal law, by interpreting it as fraud, theft or a similar charge. The individual guarantor scheme is widely used by banks and credit unions, although there are reports that this type of loan has a lower repayment performance than mortgage loans. Another disadvantage is that poor borrowers may be forced to seek better-off neighbours as a guarantor, which may reinforce dependency relations on the local level. Group liability schemes function under certain conditions but cannot be considered a panacea to collateral requirements. It requires a strong social network to support joint liability, and also a great ability of the lending institution to gain and maintain legitimacy by embedding its operations into the local values and sense of justice.

161. Finally, the requirement of compulsory deposits as a condition for having access to loans seems to work in certain situations. One of them is where clients are wage workers and therefore can easier comply with the savings obligations, both because of their cash flow characteristics and because of their lower propensity to invest, compared to small entrepreneurs. Another is where the opportunity cost of capital is very high and the additional transaction cost of compulsory deposits is an acceptable barrier for the borrowers.

162. The other solution to the collateral problem is to replace tangible collateral by some sort of social capital: the tactics of "tying the client" and establishing a long-term relationship with him. Urban micro-finance schemes seem to have advanced more rapidly in this field. The client is tied by high-frequency repayment schemes (daily, weekly), simplified repayment quota (annuity payments), access to higher loan amounts for good payers, and rapid loan approval procedures. These methodologies however are more difficult to apply in a rural context, at least for small farmers with strong peaks in their seasonal cash flow. Nonetheless, some features can be used to a certain extent. Most production systems allow for an early instalment, for example after the first crop harvest, instead of postponing the principal and interest payment until the end of the agricultural season.

163. Some production systems allow for monthly interest payments (f.i. dairy farming). Also the gradual incremental access to loans can be functional in a rural context as well: the low rotation of capital may reduce its impact on the short term. As loan amounts and maturity increase, the collateral more and more approximates traditional banking standards, like mortgaging with complete legal protection. This is a rational strategy because these loans can not any more be characterised as micro-finance and therefore can be handled with the traditional banking practices.

164. Apart from collateral solutions, there are other product characteristics that deserve attention. Interest rate policy is one of them. The experience in Central America confirms the thesis that interest rates for micro-credit do not need to be set at levels below the bank rate. The demand for small and short-term loans is not too sensitive to the level of the interest rate, but rather to accessibility and timeliness. Moreover the high costs of micro-lending justify loan rates that are substantially higher than the bank rates.

165. On the other hand, interest rates do matter for investment loans with (relatively) larger amounts and longer maturity. The most viable solution for this problem seems to be the shortening of the effective maturity of the loan, for instance by introducing more frequent payments of interests. Other solutions, such as the setting of substantially lower rates for investment loans, have not generated many positive experiences, basically because they are usually incompatible with the financial viability of the MFI.

166. Another product characteristic is the continuum between individual and group lending. In general, individual loans with single or group liability seem to be the most functional modes of lending. At the level of the final borrower, all successful micro-credit institutions lend to individual clients and not to collective investment projects. Practically all cases show that lending for group investments is a hopeless enterprise, although still widespread in the world of development projects. On the other hand, there are multiple interesting experiences with group liability, most of all with poor clients that do not have collateral beyond their good name. As stated above, group liability schemes depend for their performance upon the quality of the social network and the legitimacy of the lending institution.

167. Supervised credit is becoming gradually less popular as a mode of lending. The tying of credit to extension services that formulate and monitor investment projects has proved to be ineffective if applied to small farmers and micro-entrepreneurs. In urban MFIs it has never existed, but in rural credit programmes there still remain many cases where credit is tied to investment projects and technical assistance. Nonetheless, among rural MFIs with a real potential to survive, supervised credit is only applied to longer-term investments and larger

amounts, that is, where the transaction costs of supervision are proportionally acceptable to borrowers and lenders.

168. There is growing awareness among MFIs in Central America that the mobilisation of savings is necessary to be viable in the long run. Most MFIs were founded with donor money but these resources are becoming increasingly scarce. Growth therefore must be financed out of two sources: APEX funding and savings mobilisation. Consequently the MFI sector is starting to negotiate an adapted supervision regime with the regulatory authorities, with the purpose of legalising the mobilisation of savings. Meanwhile some MFIs have introduced substitutes for savings, like shares or debt notes, in order to avoid being reported to the regulatory authorities. Also the credit union sector, where savings from members have always been permitted through the co-operative law, is making efforts to submit itself to the regulatory supervision, in exchange for the right to mobilise savings from a wider public of non-members.

### **b. Processes**

169. The product design and “production processes” within the MFIs aims at balancing a twofold objective: to achieve a growing and relevant outreach among the target population and to reach financial sustainability. To achieve these objectives, a refined information system is required in order to keep track of the portfolio development and financial performance of the MFI. Most MFIs have invested heavily in information systems that make it possible to monitor the cash operations, the credit portfolio and the financial performance. As most MFIs are relatively young, it is essential to generate information very rapidly and systematically in order to accelerate the institutional learning process (f.i, risk analysis). In most MFIs there is still a lot to be done before management information systems provide sufficient timely information for daily and strategic management.

170. Transparency and accountability prove to be essential elements in creating confidence in the MFI. Most MFIs therefore provide training to new clients. This training is mainly related with the characteristics of the MFI and the rights and responsibilities of the clients. In second-tier structures, like NGOs that promote village banking, extensive and obligatory training programmes are offered to prepare the participants for their responsibilities as members and shareholders of their village bank. Also intensive technical assistance is provided in order to ensure the transparency and accountability of the operations of the village banks.

171. In the client screening process, two different methods are being used to identify good clients. Mostly used is the *gradual growth method*, where borrowers move through a succession of loans of increasing size until they qualify for larger loans with longer maturity. A few MFIs apply the *high hurdle method*, with stronger collateral requirements and more extensive screening procedures for first-time borrowers. With both of these methods, success stories can be told as well as failures. Success in the application of these methods depends basically on the client segment to be reached, the local institutional context and the managerial capacity of the MFI.

### **c. Institutional aspects**

172. In terms of ownership, private and co-operative MFIs seem to perform better than public programmes. Their ownership structure and social base makes them more equipped for operating on the frontier between the formal and informal economy.

173. Banks seem to have discovered the micro-finance sector as a potentially attractive segment. In part, the micro-credit boom has made ample funding available and international institutions like USAID, IDB and World Bank promote the participation of banks in this sector. On the other hand, several banks have developed (urban) micro-credit experiences that are very similar to the activities of urban MFIs. This in turn forces the MFIs to strengthen their competitiveness very rapidly in order not to be out-competed by the banks. In rural areas this is

not the case, probably because the development of viable products and technologies for this sector is miles behind and still in a process of R & D.

174. Another institutional aspect is the balance between owners, borrowers and depositors within a MFI. Solid MFIs have their products, processes and institutional features aligned in such a way that the interests of these three stakeholders groups are in balance. The protection of owners and depositors is reflected for example in good risk management. The credit is rationed through product and process characteristics that select borrowers with a high probability of repayment. In immature MFIs however the interests of borrowers predominate, and the access to credit is often rationed through rather arbitrary and sometimes corruptible mechanisms.

175. Also there are several promising experiences with second-tier lending to local financial intermediaries, like village banks and rural credit unions. If embedded in an appropriate enabling environment (supervision, technical assistance, finance), these local intermediaries can develop into competitive entities. In the case of village banking in Central America, most NGOs that promote village banks tend to seek the supervision of the Superintendent in order to mobilise savings legally, and the village banks evolve into a branch network of the NGO. In the case of rural credit unions, they tend to operate in a federative structure that is intended to create an enabling environment for its members. Both are strategies of seeking a sufficient scale of operations to ensure competitiveness in the long run.

## IX. CONCLUSIONS

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176. As a general conclusion it may be stated that most MFI programmes and institutions are relatively young and not yet mature. The average age of MFIs is between 5 and 8 years and it is very recent that MFIs are becoming aware of the implications of striving for sustainability and competitiveness. The process of diversifying the sources of funding is only starting. Simultaneously the private banks are becoming aware of the potential profitability of micro-credit operations, and thereby make the environment for MFIs more competitive. External funding is increasingly directed towards potentially viable MFIs. These MFIs are increasingly under pressure to put themselves under regulatory supervision. These tendencies together provide the scene for a process of “creative destruction” that can be envisaged for the coming years. Mostly in the urban micro-credit segment, it can be foreseen that competition will increase and that the limits of the market will come into sight within the next five years. This process is driving some MFIs already towards operations in secondary and tertiary cities, down to 10-20,000 inhabitants. They thereby may come close to the territory of MFIs that have their origin in rural areas and are diversifying into the urban centers in the countryside. This would probably be the clearest signal of a maturing market for micro-finance.

177. Lessons learned from selected micro-credit programmes shows that the design and implementation of successful programmes must have several essential elements. These elements include the following:

- (i) **Group formation and Participatory planning:** Organization of peer groups as guarantors for loan collateral was found to be very effective in most of the successful micro-credit programmes. Peer pressure can also be applied with close supervision to prevent abuse of loan funds and ensure repayment.
- (ii) **Savings mobilization:** Successful micro-credit programmes should have savings mobilization, which can be used as collateral or to acquire other assets. MFIs that have remained viable have had aggressive and effective savings mobilization schemes.

**Self-managed activities:** Repayment tends to be high when borrowers are allowed to control and manage their own activities. The crucial factor in ensuring low operating costs among these MFIs was involvement of their clients in the handling of financial services and administrative work. This minimized the MFI's cash costs in staff salaries and travel.

- Federating self help groups (SHGs) at the village level and their involvement in day-to-day management of group activities contributed significantly in keeping to a minimum the number of MFI staff required for clientele expansion. This is because the members themselves undertook the recruitment of new members as well as the management of savings and credit operations.
- MFIs that allowed their client groups to set the level of interest rates for retail finance realized that the group usually ensures adequate interest spread, which is vital for achieving viability.
  - All the MFIs did aim for 100% loan recovery, but the failure of some to reach near 100% levels has proven to be a reflection of the management's laxity in imposing credit discipline.
  - Client training costs have reduced the MFI's operating costs.

- (iii) **Training and skills enhancement:** The poor borrowers require training and skill enhancement for both delivery and receiving mechanisms.
- (iv) **Bank on borrower's existing skills:** Successful microcredit programmes recognize the existing skills of the borrowers and target their credit accordingly. They start with what the poor client knows, and also provide for upgrading skills and learning new skills with the aim to improve the creditworthiness of the less-educated poor clients.
- (v) **Systematic monitoring and evaluation:** Regular monitoring and evaluation through an efficient MIS enables timely problem solving. Transparency is required in all transactions and regular monitoring of bank accounts is important. Feedback mechanisms improve communication in projects.
- (vi) **Government support and cooperation:** Government policies considering poverty alleviation as a priority in national economic plans and microcredit programmes as a key strategy support with funds from government budget, bilateral and multilateral assistance and donations.
- (vii) **Interest rates that cover costs:** Successful microcredit programmes are characterized by non-subsidized interest rates linked to competitive market rates. This enables MFIs to continue operations at rates that remain lower than the informal financial sector, but high enough to account for inflation, cover administrative costs and gradually achieve viability and sustainability of the programmes.
- (viii) **Simple procedures:** Loans should be disbursed quickly, on time and the lenders should be easily accessible to the borrowers.

178. Although the micro-finance industry has evolved out of a non-profit, development community, it faces the challenge of becoming commercial in order to maintain a steady growth level in the long term. Micro-finance can only be fully established itself as a pioneering industry by successfully combining the practices and behaviors of the business community with the social mission of the development world. To achieve high and sustainable rate of growth, MFIs need to expand their resources in the interest of maximizing their outreach and profitability, and at the same time minimize costs and risks involved with serving a population living in poverty.

179. The objective of policymakers therefore, should be to support MFIs in all possible ways and facilitate the provision of sound, responsive and market-based financial services to benefit both poor clients and the MFIs that serve them. The policymakers should set up an appropriate legal framework to allow and promote MFIs' access to different forms of capital and ensure efficient business practices to attain sustainable scales of operation. To mitigate the risks involved with utilizing private capital, MFIs need to meet common standards on financial performance and operate within an appropriate supervisory framework. The underlying principle for adopting financial standards and supervisory practices should be to facilitate and not control MFI operations. It should facilitate further innovation in MFI practice so that more sophisticated MFIs evolve over time. The policymakers involved with regulation and supervision issues should be educated on the system of micro-finance to help them in designing appropriate regulatory standards and supervision guidelines. Therefore, the elements that contribute in enhancing the micro-finance include:

- a) The planners, policymakers, MFI leaders and workers should have a vision that is bold and demands commitment, and is driven by an almost missionary zeal for work. All stake holders, including the clients, must believe that one can successfully 'bank with the poor', that the risk involved can be managed. As such most urgent requirements for MFIs are in the area of human development, especially the quality

of leadership from Board members and senior staff, skill development among general staff and empowerment of potential poor clients to have faith in themselves and the MFIs as deposit-takers and resource managers.

- b) Support of necessary policy and legal reforms that will nurture the spread of village banking and SHGs and increase their ability to link effectively to registered banks and other institutions in the mainstream financial sector. Many SHGs and village-based MFIs do not have the authority to carry on the micro-financing and savings activities because they lack recognized legal identity. The Government must confer the legal authority to MFIs, and create the environment in which the MFIs can function effectively.
- c) Substantial increased funds for training, infrastructure and on-lending. MFIs should have increased access to new sources of funds, including those available as a result of increased savings mobilization and improved profits through the adoption of pricing policies that support profit margins needed to cover the cost of services provided.
- d) Financial viability is a must for significantly expanded and sustainable financial services by MFIs for the poor. MFIs must be bankable, as they believe are their poor clients. MFIs working with the poor must take a decision that they will ensure financially viable operations. They need to take concrete steps particularly in:
  - setting appropriate interest rates not only to attract savings deposits but also to establish adequate spread between the cost of funds and the interest on loans;
  - designing loan products that could meet various credit needs of the poor;
  - maintaining credit discipline to obtain 100% loan recovery rates; and
  - Encouraging entrepreneurial activities among the clients to improve their capacity for credit absorption.
- e) Continuous motivation work to encourage the clients to save and borrow and proliferation of SHGs specializing in various aspects
- f) Greater attention by MFIs to improve their management, information system, recruiting standards, accountability and ability to learn from their own experiences and those of others. The MFIs must give greater attention to management and strategic planning and promote national, regional and international networking.



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