MODULE 2

MICROFINANCE METHODS

Why do you as a Peace Corps Volunteer (PCV) need to know about financial services for the poor? Because you decided to spend two years of your life as a development worker helping people help themselves, including the "poorest of the poor." The experience of development agencies shows that when the poor have cash to purchase productive assets they can increase their incomes and break the poverty cycle. By the time you complete this module you should have the knowledge, skills, and attitudes to:

- Explain why the lives of the poor would improve if they had access to nonexploitative credit and savings services.
- Describe three nonformal traditional methods used by the poor to acquire financial services and why none of these adequately satisfy the families' needs for financial services.
- Identify the lessons learned from nonformal traditional financing methods, which led to the development of today's microfinance institutions (MFIs). State how these lessons were incorporated into MFIs.
- Describe for someone unfamiliar with financial institutions the different MFIs offering financial services to the poor: commercial banks, Latin American solidarity groups, Grameen Bank, village banks, savings and loan associations, and credit unions.
- Express an opinion as to how Volunteers can best contribute to the development of your host country in the area of microfinance.

FINANCIAL SERVICES

In this module we first look at local families' credit and savings habits and the role banks play in providing services. Second, we uncover the types of financial services that allow the poor to access these services. Third, we familiarize you with the traditional providers of credit or savings: moneylenders, middlemen, and Rotating Savings and Credit Associations (RoSCAs). Finally, we show how lessons learned from these traditional providers of financial services have influenced the design of today's MFIs.

What financial services do families want? One size of financial services does not fit all! Banks and credit unions tailor different financial products to fit different customers. What types of financial services did you use in the United States—a checking and/or savings account; credit or debit cards; student loans; loans to buy a car, a house, or start a business; wire transfers; or cashier's checks? You have doubtless used some or all of these. How did you feel when you applied for a loan? Nervous? Were the application forms long and complicated?

ACTIVITY 2:1

FAMILY FINANCIAL HABITS

Talking about money is a sensitive issue. When talking with your host family, other friends in the community, or trainers, ask questions in an appreciative, non-threatening way. Keep it general. Ask, “What do most people do?” not “What do you do?” Explain that you are trying to learn what financial services people in the country use, and what characteristics of these services they like and do not like.

If language is a problem, you will need to be creative. Possibilities include getting the questions translated into the local language, finding someone to interpret for you, or inviting host family members to share this information during a language class.

- Do most families in the community save? Where do they put their savings: in the bank, in hard assets such as jewelry or houses, or in a safe hiding place (under the mattress)? If savings are put in the bank, what interest rates are paid on the savings?
- Do most families in the community borrow money? Why do they usually borrow? From whom do they borrow: banks, moneylenders, middlemen, or family? What interest rates are common? Do they have to secure a loan with collateral?
- How are family financial decisions made? What type of decisions do men make? Women? What decisions are made jointly?

Information gathered through this activity will be more comprehensive if you share and compare what you have learned with fellow trainees.

Who provides formal financial services? Banks are the institutions people normally associate with financial services. Competition forces banks to offer services their customers want at competitive prices. However, in a number of countries there is little or no competition, and banks may or may not meet the financial needs of community members. To learn about local banks visit a bank, talk with a banker, observe who the customers are, and learn about the bank's financial products and services.

ACTIVITY 2:2

BANK VISIT

A visit to a local bank is a chance to learn about what formal financial services are available, at what price, and who uses these services. You may want to organize a group of trainees/Volunteers and invite a language teacher to accompany you. Find out about local banking services by asking the following questions appreciatively:

- What are the bank's strengths; what about the bank does the staff point to with pride?
- What services does the bank offer?
- What is the minimum amount needed to open a savings account?
- What interest rates do savings accounts pay, and what interest rates are charged for loans?
- Who are the bank's borrowers (men or women, age, income level), why do they borrow, and who are their customers?
- Must the borrower have collateral to secure a loan?
- How long does it take to process a loan?

How do the services the bank offers match with the services families in your community use and would like to have? Does it seem the bank is doing a good job of serving the financial needs of the community? If not, why not?

Poor families need financial services, too. Check the characteristics of financial services you feel would be desirable for a customer who is poor and possibly illiterate.

___ Low minimum deposits

___ Available in the neighborhood

___ Small loans

___ Market-based interest rates

___ Managed by local people

___ Quick loans

___ No collateral requirements

___ Savings kept in a safe place

___ No minimum balances

___ Reasonable fees

___ Rules sensitive to the special needs of women

Did you check them all? Good! The poor want and need safe places to keep their savings, quick loans at market interest rates, and a financial institution managed by local people they trust and who trust them.

Even as we enter the 21st century, the majority of poor families and individuals on our planet have no readily available affordable financial services. In many rural areas banks, savings and loan associations, and credit unions are nonexistent. The formal financial institutions that do exist do not consider the poor creditworthy, because the poor lack collateral to secure loans. This is especially true of women, who in a number of countries own no property or fixed assets due to legal restraints or cultural norms.

Savings accounts also are problematic; the savings of poor people are of little interest to banks. Transaction costs decrease the profitability of small accounts. Minimum balance requirements, complicated procedures to open accounts or withdraw savings, and a lack of trust discourage the poor from putting their money in banks. Illiteracy is another barrier to accessing formal financial institutions. It is impossible to fill out a savings or loan document if you cannot read or write. Again, women are impacted disproportionately; their illiteracy rate greatly exceeds the rate for men.

The habit of saving and building a safe, easily available financial cushion to soften the blow of life's unexpected emergencies is thought to be of even greater value to the poor in improving their economic condition than access to credit. Savings tend to be valued more by women than men; a primary concern of women is the security and welfare of their children.

Savings:

- Provide families with the ability to survive economic crises.
- Encourage people to look beyond daily or weekly income cycles and think about how to use money for long-term goals.
- Allow for risk taking. With even a minimal increase in security, a poor woman can think about diversifying some of her activities to generate income.
- When managed by a group, become a vehicle for bringing women together to talk about both personal and community issues.
- Give people some control over their lives.
- Enhance the welfare of children. Women's income is most often spent on improving the lives of their children. The sense of security derived from having some savings is passed on to the children.

TRADITIONAL INFORMAL FINANCIAL SERVICES

Historically the poor have relied on informal sources such as Rotating Savings and Credit Associations (RoSCAs), moneylenders, and middlemen to try and meet their financial needs. These sources suffer serious limitations in their ability to provide viable financial alternatives for the poor.

Moneylenders are where the poor traditionally go when they have no other options. Moneylenders charge high interest rates; over 100 percent annual interest is not uncommon even in countries with mild inflation. However, loans from a moneylender have certain desirable features: they are granted on the spot (no long wait for credit approval and loan processing), the borrower's reputation in the community is more important than collateral, and the moneylender is conveniently located right in the borrower's hometown. But, after the principal and a large amount of interest are repaid, the borrower may be no better off, and possibly worse off, than before taking out the loan.

Rotating Savings and Credit Associations are, next to the moneylender, the most prevalent type of informal finance source around the world. RoSCAs existed in China 1,500 years ago. (Jeff Ash, president and founder of Working Capital, in a lecture given to participants of the Microenterprise Institute, New Hampshire College, June 1999.) People form a RoSCA by inviting individuals they trust to join. The group decides how often and where they will meet, how much will be collected at the meetings (the group is self-managed). Each time the RoSCA meets, every member contributes a small set amount of money. Then the group decides who will receive the total amount collected, usually one member. When every group member has received funds from the group one time, the cycle is complete. The group dissolves and may freshly reorganize.

As an example, seven market women choose to contribute $1 to their RoSCA fund every Monday morning, forming a pot of $7, which one woman receives at the end of the week. Over the course of seven weeks each woman receives one pot of $7 and also contributes $7 to the pot at the rate of $1 per week. The first people to receive the pot are, in essence, receiving interest-free loans from the other members. The last members to receive the pot are no better off financially than if they had simply saved up their own money on a weekly basis.

Benefits of being a RoSCA member go beyond establishing a pattern of regular savings and receiving a lump sum of money. The group discusses problems and offers each other advice and mutual support. Unlike moneylenders, RoSCAs charge no high interest, but the amount of capital that can be collected by this process is limited. It may not be sufficient to start or expand a small income-generating activity—a microenterprise.

In many countries, RoSCAs have turned into permanent, nonrotating credit associations with their own loan funds. Most have stayed informal, but some have adopted the legal status of a cooperative society.

RoSCAs go by different names in different countries. RoSCAs, like moneylenders, provide funds locally with no complicated procedures, and membership in a RoSCA is by invitation from the group. RoSCA members depend on and trust each other to put money "in the pot" at every meeting. A member who takes his or her share of the funds but fails to contribute throughout a cycle experiences peer pressure and develops a reputation in the community for being unreliable.

Middlemen make loans for the purchase of raw materials, or they sell the raw materials, sometimes at inflated prices, to poor producers. The producers are then obligated to repay the loans or cost of raw materials by turning over their products to the middlemen at submarket rates. It is not unusual for middlemen to have a monopolistic hold over small producers, particularly in agriculture. Interest rates on a loan from a middleman are also extremely high.

ACTIVITY 2:3

ROTATING SAVINGS AND CREDIT ASSOCIATIONS

This activity is designed to determine:

- Are RoSCA-like groups known in your community. If so, what are they called and how do they work?
- What about moneylenders? Where and how do they operate? What interest rate do they charge?
- Do middlemen advance money for crops, securing the crops at submarket prices?

Who do you know that might have the answers to these questions?

Form a RoSCA. Invite those you trust to join a RoSCA to learn how RoSCAs work. At your first meeting you will need to decide: (1) how often and where you will meet; (2) how much money each member will contribute; (3) how it will be determined who gets the pot of money at the first meeting, the second, the third, and so on.

After a savings cycle has been completed (every member of the RoSCA has received the pot of money one time), think about:

- What benefit was the RoSCA to you? Would the answer be different if you were poor?
- How did you feel if you were the first, or not the first, to receive the pot of money? Did the selection process seem fair?
- Did all members pay on time? If not, what did the group do?
- Did you enjoy the social aspect of RoSCA membership? Why or why not?

MICROFINANCING METHODOLOGIES

Over the past two decades, development agencies, governments, and even private donors have experimented with a variety of methods to provide the poor with cash to establish microenterprises. This is because in areas as distant as Southeast Asia and Latin America people have realized that microenterprise works.

Indeed, microenterprises are the only income option for many underprivileged and undereducated families. When there are no jobs or jobs for which they are not qualified, poor working people have no other option but to start their own business. These businesses are small microenterprises. It is surprising when one business grows to employ more than just family members. But, most important, there are many success stories of these businesses generating enough income to more than meet the family's basic needs.

Starting or growing a business without money is nearly impossible. Businesses need raw materials and the workers need tools. Development workers observed how small amounts of cash allow the poor to acquire these assets, increase their productivity, and improve their economic well-being. About 20 years ago, a few innovators designed and piloted new financing methodologies. Today these methodologies are bringing microfinance services to hundreds of thousands of low-income individuals and families.

The most successful financing methodologies built on lessons learned from the traditional financing sources of the poor: moneylenders, middlemen, and RoSCAs.

From moneylenders innovators learned:

- Easy, quick, local access to credit is important.
- The poor have the ability to pay high interest rates.

From middlemen they learned:

- For poor farmers, borrowing and repayment is tied to the timing of crops.
- The poor often borrow to finance income-generating activities.

From RoSCAs they learned:

- The poor can save small amounts on a regular basis.
- Groups function best if they select their own members.
- Members are free to leave the group only at the end of a cycle.
- Peer pressure works to enforce agreements made by the group.
- People enjoy and benefit from group support and joint problem solving.
- The poor are capable of self-managing their groups.

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A LEARNING MOMENT

To increase the probability of success and sustainability, design new projects based on what has worked traditionally in the culture.

Below, discussed in general terms, are the most common varieties of the new breed of microfinance methodologies. Of all existing credit and savings programs, no two are identical in methodology, even those sponsored by the same organization. This is in fact appropriate, because the specifics of a program's methodology should be chosen to match the target group and local operating environment. Remember, "one size does not fit all!"

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In 1997, the U.S. Agency for International Development (USAID) provided $85,106,000 in funding for microfinancing activities to 221 indigenous NGOs, 103 private volunteer organizations, and 79 credit unions. (*Reaching Down and Scaling Up: Meeting the Microenterprise Development Challenge.* USAID. Washington, DC. 1997. p. 27.) Many other development organizations, including the World Bank and United Nations, realize the value of microenterprise creation and fund microfinance projects.

Individual lending is the oldest form of microlending and most closely approximates traditional commercial bank lending. Developers of individual lending programs attempt to modify bank methods to better meet the needs of low-income borrowers and at the same time allow banks to earn a reasonable profit and be assured default rates are kept under control. This is not an easy task.

The general strategy to reach the underprivileged is to relax loan requirements for the poor. Still, somehow these loans must be secured, either by the borrower's collateral and/or by cosigners, or they are disbursed to groups, where members of the group guarantee the repayment of each other's loans. To further reduce the risk of default, loan officers investigate the creditworthiness of the borrower and the soundness of the operating business or business plan. These procedures take time. Often several weeks lapse between loan application and disbursement of money.

Advantages include loan amounts and repayment schedules tailored to the specific needs of the business. Typical loan amounts range from $100 up to $3,000, and loan periods from three months to over one year. Customized loans have a price, however. The transaction cost is high, and costs are passed on to the borrowers. Individual loans are effective in supporting small businesses, but not in serving the "poorest of the poor." Procedures are too complicated, the waiting time for the loan to be processed is too long, and collateral or a cosigner often is not available. Clients are more often male than female.

Latin American solidarity groups consist of four to seven members. Groups self-select members and guarantee each other's loans. A new cycle of loans cannot be started until all loans taken out by group members have been repaid. Initial loans are small, in the neighborhood of $50, and repayment is required in two to three months. When members repay their loan on time their credit limit for the next loan is increased by about 20 percent, up to a maximum of about $300. Interest rates are normally higher than commercial banks, but lower than moneylenders.

Clients are usually required to deposit regular savings if they want to be part of the group; savings cannot be withdrawn until the member leaves the group. Savings serve as a compensating balance, guaranteeing a portion of the loan.

The microfinance institution gets loan capital from grants or loans from development or commercial organizations. The goal of the microfinance institution is to reach sustainability. If the microfinance institution is not sustainable, its clients will again be without financial services. To achieve sustainability they must earn enough profit from their group lending activities to repay any loans and build up their own lending fund. Therefore, interest rates plus any client fees must be set to cover operating costs, repayment of any loans plus inflation, and an extra amount to develop a self-sustaining loan fund. To generate the needed profit, costs must be kept low. Transaction costs are minimized because:

- The mutual guarantee of members' loans reduces the time that loan officers need to spend reviewing individual loans.
- Loan repayment rates are high, usually more than 95 percent, reducing time spent in follow-up on unpaid loans.
- Procedures are standardized. Loans can only be taken out in standard amounts (example $50, $60, $72, etc., up to a maximum of about $300); all group members borrow at the same time and repay on a set schedule, perhaps weekly at group meetings.
- Simple procedures, flat interest rates, and equal loan payments keep bookkeeping costs low. Example: A $100 loan at five percent per month interest to be repaid in eight weekly payments will have weekly payments of $13.75. ($100 principal + 2 months x $5 per month interest = $110. $110/8 weeks = $13.75 per week.)
- Group members help each other with their businesses, solve problems jointly, sometimes make loan payments for members who are having especially difficult times, and exert peer pressure to collect loans and interest.

Initially, most of the clients were female urban market vendors who used the loans for working capital. Today, the Latin American solidarity groups are also found in rural areas, and still clients are mostly women. Microfinance institutions prefer to lend to women—their loan repayment rate is higher, and they use almost all of their profits for the welfare of their children.

Advantages: Loans are quick, no collateral is required, savings are part of the program, and clients build their capacity to manage money by starting with small loans and gradually increasing the amounts. Disadvantages: There is no flexibility of the timing of the loan, group members all borrow and repay their loans at the same time, and savings can only be removed if a member leaves the group.

In Kazakhstan, VOCA (a U.S.-based private, nonprofit international development organization) worked with a national women's NGO to form a successful microfinance institution based on the solidarity-group methodology. Loans are higher than in developing countries, $200 to $1,000, because of the cost of living. The clients are both men and women, and most start their own shops. The NGO had to go to the expense and effort of registering the microfinance institution as a bank. Kazakhstan laws prohibit anyone but a bank from collecting savings. Volunteers were involved in training the solidarity group on forming a group, working together, and techniques for group decision making.

Did you find that RoSCAs and the Latin American solidarity groups have some common characteristics?

The Grameen Bank is, without doubt, the most widely known microfinance institution in the world. Grameen-style lending programs form small, five-member self-selected solidarity lending groups that are then incorporated into village "centers" composed of up to eight of these lending groups. These centers are then grouped into regional branch offices. Thus, the institution is built "from the ground up," with clients or members assuming responsibility for much of the management of financial services. Over 94 percent of clients are women, and loans are used for income-generating activities. Loans are repaid over one year with weekly payments. In 1983, the Bangladesh government licensed Grameen as a bank.

Groups are self-selected and manage themselves, making decisions as to which members receive loans. New groups must meet and save for a minimum of four to eight weeks before group members become eligible for their first loan. New borrowers initially receive small loan amounts, payable over periods of up to 12 months. When clients have established a good repayment history, loan amounts are increased. Loans range from $50 to $300. Members are required to save a percentage of their loan (generally five percent) over the loan repayment term through regular weekly installments. When members leave the group, they receive their portion of accumulated savings.

Members' savings and some fees are kept in the village. These funds can be lent to members or used to form special "emergency funds," managed by the village centers to assist members in need.

Program staff (loan officers) have fewer responsibilities than in the Latin American model. They are responsible for forming new groups and explaining how the Grameen Bank functions; keeping the program running smoothly; dispensing payments; recording loans, savings, and payments; and collecting money for safekeeping. Solidarity group members are the decision makers.

Advantages and disadvantages are the same as the Latin American model, with the addition of two advantages: (1) The "emergency fund" for members in need; and (2) groups have more autonomy in decision making, giving them some control over their finances.

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A LEARNING MOMENT

Repaying loans gives people dignity and confidence. Accepting donations makes people feel dependent. Taking a loan, running a small business, repaying the loan, and taking another loan: it is a cycle that gives borrowers a strength they could never get from a handout.

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Village banking (VB) was developed by FINCA, a U.S. NGO, through its work in Central America. It is probably the most commonly practiced community-managed loan fund methodology. A village bank is generally comprised of 30 to 50 members, mostly women. Bank members elect a management committee, which approves loans, collects savings and loan payments, and does most of the bookkeeping. (*CARE Savings and Credit Sourcebook,* Charles Waterfield and Ann Duval, CARE, New York, 1996 p. 110.)

The bank is financed through internal mobilization of members' funds (managed through an internal account), as well as through loans provided by the lending institution (managed through an external account). The external account is funded by a loan made to the village bank at commercial interest rates. The term of this loan is usually 10 to 12 months. All village bank members are responsible for repaying the village bank's loan and interest on that loan. Over time, the internal account, which is comprised of members' savings, share capital, and accumulated interest, is expected to grow large enough to replace the external account. An important objective of this methodology is that within a three-year period each village bank will be independent financially and in the administration of the bank.

This approach has been successful in reaching the rural poor, especially those who operate or want to operate income-generating activities. Village banks charge market interest rates. Initial loans are in the range of $50.

The field agent, commonly called a promoter, is responsible for helping communities start new village banks and for regularly visiting existing village banks. The field agent brings cash for loans and takes excess cash for safekeeping in a commercial bank, verifies the village bank records, and helps resolve problems, but does not approve individual loans. Some internal fund money is left with the village bank's managing committee for emergency loans to members.

Over each loan cycle members are typically required to save an amount equal to at least 20 percent of their loan. The goal is for members to save as much as $300 in three years. Savings are a strong component of the village banking methodology.

Village banking is theoretically more efficient than the Grameen model or Latin America solidarity groups because the field agent can serve larger numbers of clients. The clients do almost all the work of providing financial services, and they normally do a good job. All transactions are transparent; money is exchanged with the management committee present. Default rates on loans are low because the management committee knows the reputation of the loan applicant and if their idea for use of the loan will work under local operating conditions.

An added advantage of village banks and similar participatory financial service methodologies is the experience members gain through the process of electing a management committee and managing their own funds. These activities build social capital (the bonds of interpersonal trust and reciprocity that facilitate collective action). An increase in the social capital available in a community can be a powerful force in a community. It enables people to work together to achieve community goals.

The final activity in this module will give you a chance to understand more about village banks by attending an organizational meeting for a village bank group as you play the Learning Game.

An NGO's Story

Catholic Relief Services/Senegal (CRS/SN) provides a good example of village banking (VB) program methodology. In that program, membership is based on self-selection, and the number of members in each village bank depends on the capacity of their management committee. CRS/SN suggests that between 35 and 75 members are an efficient and workable number. Members design and approve their own bylaws and elect a management committee comprised of a president, a secretary, and a treasurer. Within each VB, members divide into smaller solidarity groups of six to 10 members. The concept of solidarity is enforced in the program. If one member fails to repay her or his loan, the solidarity group is responsible for repaying the loan. If one group fails to repay its loan, all members of that VB are held responsible. And, if one VB fails to repay its loan from the NGO, all other VBs are held responsible for repaying the loan. No new loans are made until the previous loan has been completely repaid.

Each VB member receives an initial loan of $30 to $40 from the external account (the loan fund provided by CRS) to invest in income-generating activities. At the end of a four-to-six-month cycle, members reimburse the entire loan principal and the 15 percent interest rate in one bullet (balloon) payment. The interest is divided between the counterpart organization to cover its administrative costs and the village bank to cover recurrent costs and increase its internal account fund. To qualify for subsequent loans, members are required to save a minimum of 20 percent of the external loan amount. Individual loan amounts can increase each new cycle by the amount of that member's accumulated savings during the previous cycle, thus encouraging members to deposit additional voluntary savings. Members' monthly savings, interest payments, and various fee incomes constitute the internal account fund. The VB is the sole owner of the internal account fund. Each month, the VB disburses loans amounting to the entire value of its internal account. These loans are made to members of the VB or the counterpart organization who are not members of the village bank. The internal account loans are on a monthly basis at 5 to 10 percent interest. The interest rate is higher for internal account loans, thus encouraging members to use the external account.

Credit unions (CUs) rely totally on the savings and fees paid by their members to build a loan fund. They are financially independent from their creation. Community-based CUs often consist of 30 to 100 members.

A field agent assists in the formation of the group and provides technical assistance. CUs set their own terms and conditions for loans to be made to individual members. The amount of a member's loan is often determined by the amount the individual has saved. CUs may use members' savings to secure a loan or may require some form of collateral to guarantee loans. The collateral might be a small household asset, a bicycle, or a goat. However, like Latin American solidarity groups, the Grameen Bank, and village banks, CUs rely primarily on their knowledge of the individual member and local operating environment to make sound loan approval decisions. The loan committee may advise the lender to revise his or her business idea before a loan is granted.

When there are a number of CUs in an area they sometimes join together in a formal or informal federation. They do cross-financing and training. Ultimately, it is possible to unite a number of regional federations into a national federation.

The major disadvantage of these institutions is that members must save for a considerable amount of time before loans are made. A second disadvantage is in the governance of CUs. The board of directors consists of members only. They are elected by the membership; each CU member has one vote, no matter how large his or her savings account. The Board may be made up of individuals who are popular but lack the skills and experience to oversee the CU. The major advantage is the independence members have in organizing the CU to meet their financial service requirements. Each CU is autonomous.

The chart at the end of Module 2 summarizes the general principles of microfinance lending methodologies. The principles of clients, loan approval, loan characteristics, guarantees, savings, and group characteristics are presented for individual lending, Latin American solidarity groups, the Grameen Bank, village banking, and credit unions.

ORGANIZATIONS INVOLVED IN MICROFINANCE

The MFIs that implement group-lending methodologies such as the Latin American solidarity groups, Grameen Bank, and village banks are usually indigenous NGOs or a division of an NGO. Some MFIs are registered as for-profit businesses. Credit unions are normally registered as financial institutions and have to comply with the regulatory requirements. Complying with regulatory requirements is an additional cost for an MFI. In a number of countries an organization can make loans, but it cannot collect savings unless it is a regulated financial institution. A regulatory system assures the safety of the savings.

Governments and private development organizations in European Union countries, Japan, and the United States (such U.S. development organizations as CARE, Catholic Relief, Freedom from Hunger, Save the Children, and World Relief) are actively involved in supplying funds and technical support for MFIs in developing and redeveloping countries.). Most do so by partnering with indigenous NGOs. The international partner supplies the initial loan fund, microfinance methodology, and technical training. The NGO modifies the methodology to fit the local situation, is accountable for the loan fund, and employs field agents (loan officers) who work with the village groups. The NGO is the MFI, or the MFI is operated by the NGO responsible for the day-to-day operations and working to become self-sustainable.

In some African, Latin and South American, Asian, Central Asian, and Caribbean countries, Volunteers work with MFIs or local NGOs that operate them. These Volunteers assist the organizations in improving their operations, planning for sustainability, and delivering business training.

ACTIVITY 2:4

THE LEARNING GAME

The modified version of the Learning Game is a three-hour simulation of key events in the promotion, organization, training, and implementation of a credit association (a modification of the village banking methodology). The game includes role playing and stories. It is an enjoyable way to learn how group-lending microfinance works. Invite some host country friends to join you in the game. The number of participants in the game can range from 15 to about 30. Although the game is written in English, it would enrich the learning experience to do the role plays and stories in the local language that you are learning. If there is a microfinance institution near your training site, involve some of its staff as presenters in the game, and perhaps modify the game to fit their microfinance methodology.

KEY TERMS

Key terms are defined as they are used in the module. A __space__ is provided to write the local language translation of the word or phrase. Work with your language instructors to determine the best translation and build your technical vocabulary as you study this module.

Collateral is property or other assets used to guarantee the repayment of a loan.

Simple interest is the cost for the use of money calculated on the full amount of the loan over the entire outstanding period of the loan. For example, if $100 is loaned for 12 months at 12 percent annual interest, with equal payments made to repay the loan plus interest each month, the simple interest is $12 ($100 [loan amount] x .12 [12 percent interest rate] = $12 interest). Each equal monthly payment would by $9.33 ($112 [loan amount + interest] / 12 [number of months of loan] = $9.33).

Financial services include providing both credit and savings products.

Social capital is the interpersonal trust and reciprocity that facilitate collective action.

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RESOURCES

*An Institutional Guide for Enterprise Development Organizations***.** Elaine Edgcomb and James Cawley, Editors. (The Seep Network.) 1993. 299 pp.

A guidebook prepared by members of the Small Enterprise Education and Promotion (SEEP) Network's Institutional Development Working Group to help private development organizations plan and implement small enterprise development programs. Deals particularly with the objectives of sustainability, institutional development, and expansion, addressing the questions that organizations need to consider at each stage of a program's development. A tools section contains a variety of formats, sample documents, question guides, and other materials to help in the various planning and implementation processes, e.g., creating boards of directors, hiring staff, arranging contracts, and establishing credit mechanisms. Also includes a bibliography and glossary.

*Our Money, Our Movement: Building a Poor People's Credit Union***.** Alana Albee and Nandasiri Gamage. (IT Publications, Ltd.) 1996. 46 pp.

Describes in detail the working of credit and saving mechanisms used by the Women's Credit Union in Sri Lanka. Illustrates how financial services can be controlled and managed by the poor, instead of being delivered to them. Describes how people's efforts can shift economic views of development to include cultural and social aspects.

Internet:

www.mip.org

www.UNICEF.org — Good resource especially if looking at statistics worldwide on economics.

Other Materials:

Village Banking–The State of the Practice, Candace Nelson, Barbara McNelly, Kathleen Stack, and Lawrence Yanovitch. UNIFEM 1996.

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TRAINER'S NOTES

MODULE 2
MICROFINANCE METHODS

Overview:

In this module we look at the financial habits of local families, and we learn about the financial services the local banks provide. We provide a historical perspective of financial services with visits to the world of traditional moneylenders, middlemen, and Rotating Savings and Credit Associations (RoSCAs). At each stop trainees increase their understanding of the customers and suppliers of financial services in their country of service.

Readers are encouraged to discover for themselves the credit and savings habits of local families and what financial services local banks provide. The module also examines traditional financial services providers and how learnings about the poor people's traditional credit and savings habits and ability to pay were used to design today's MFIs. The Learning Game offers a chance to be an active participant in a microfinance activity.

Time:

Reading	1 hour
Activities	4 hours
The Learning Game	3 hours

Materials:

Copy of the Learning Game and handouts called for in the game's instructions. Articles on the nation's banking system and/or local MFIs would supplement trainees' observations.

Preparation:

- Schedule times within the training for trainees to take field trips to banks. The amount of time will depend on local logistics.
- Enlist the help of language instructors for those activities where language may be a barrier.
- Work with one of the trainees (a trainee who enjoys theatrics is a good choice) to organize and lead the Learning Game.

Continued

Trainer's Notes, continued

- Spend at least one hour, after reading the text and completing the activities, discussing with trainees their mastery of learning objectives and processing module learnings.
- There are social and cultural considerations when interacting with community members. Before beginning the activity brief trainees and community members on expected behavior and cultural norms. This increases the comfort level for everyone.. If host family members or local friends are invited to a language class or other training session, what social courtesies should be extended? Should you offer tea, coffee, or sweets before or after the discussion? What are expectations as to greetings and introductions? If you visit a family or business to gather information, should you take a small gift? What gift is appropriate?

Debriefing the experience and processing the learnings:

Experience is only the first step in the experiential learning cycle. Reflection, generalization, and application follow experience. Don't stop the training before completing all four steps. Allow adequate time and opportunity for reflection, generalization, and applying the learnings to the trainee's Peace Corps Service.

In debriefing the module and processing the learnings, remember the trainees are responsible for their own learning. It is to be expected that trainees will have different interests and approaches to acquiring information. Two reasonable individuals can see the same thing and disagree about what they saw, how it should be interpreted, and/or the applicability of the information.

A skilled trainer adds value by providing an emotionally safe environment where participants can reflect on what they have observed; explore their feelings; and consider how learnings can be used during their Peace Corps service. Trainers are a learning resource. They may be able to fill in information gaps, correct inaccurate impressions, and illustrate how the national laws, economy, and culture affect what trainees have observed.

Before completing the module check with trainees to determine if they feel the learning objectives were accomplished. If not, what additional information or activities do they require to achieve the objectives?

TRAINER'S NOTES

ACTIVITY 2:1
FAMILY FINANCIAL SERVICE

Overview:

This activity is designed to teach trainees how families in the local community use financial services.

Time:

To collect information:	1 hour (approx.)
To discuss results:	30 minutes

Materials:

None.

Preparation:

Work out a plan with trainees, given their language capabilities, to gather information on local families' credit and savings patterns and financial service requirements. It might be useful to have language teachers' help prepare questions in the local language with spaces where host families could write answers.

Debriefing the experience and processing the learnings:

Financial services should (1) meet the consumer's needs, (2) be readily available, and (3) be reasonably priced. Do the financial services available in the host community meet these criteria?

TRAINER'S NOTES

ACTIVITY 2:2
BANK VISIT

Overview:

This activity is designed to teach trainees about the financial services offered by formal financial institutions.

Time: 2 hours

Materials:

None.

Preparation:

Trainees should set up bank visits on their own. However, they may need your assistance in identifying which banks to approach and what approach is culturally acceptable—a written request, a phone call, or a request on behalf of the trainee by a community member. Before they visit the bank, trainees should be coached on culturally correct conduct for business meetings.

Debriefing the experience and processing the learnings:

What were the surprises, if any? What customers were observed in the bank (businesspeople, men, women, and/or people who did not appear to be well off)? Are the bank's location and hours convenient? Did the customer service seem friendly?

TRAINER'S NOTES

ACTIVITY 2:3
ROTATING SAVINGS AND CREDIT ASSOCIATIONS

Overview:

The goals of this activity are twofold: first, to learn about local RoSCA and moneylender activity; and second, to experience group dynamics of a RoSCA.

Time: 3 hours

Materials:

None.

Preparation:

If you do not have knowledge of moneylenders and middlemen practices in the local community, investigate this before conducting the activity.

Debriefing the experience and processing the learnings:

A local trainer can add value to this activity by assessing if the information gathered reflects reality. There is a "learning moment" following this activity to discuss with trainees how their RoSCA group made decisions and broaden the discussion to include group decision-making techniques. Introduction of decision-making tools such as multiple voting or decision matrix may be desirable.

TRAINER'S NOTES

ACTIVITY 2:4
A LEARNING GAME

Identify a trainee/Volunteer who will organize and facilitate the Learning Game for other trainees/Volunteers and invited host country nationals. Talk with the language instructors in advance to enlist their help in working with the trainees/Volunteers to do the Learning Game in the local language.

GENERAL PRINCIPLES OF THE LENDING METHODOLOGIES

Principles	Individual Lending	Latin American Solidarity Groups	Grameen Bank	Village Banking	Credit Unions
Clients	Individual businesses	Microenterprise owners	Microenterprise owners	Groups are clients	Groups are clients
Loan Approval	• Based on careful viability analysis	• Based on minimal viability analysis	• Group involved in loan appraisal	• Group loans processed by agent • Individual loans analyzed by group	• Individual loans analyzed by group
Loan Characteristics	• Loans adapted to client needs	• Limited range of loan conditions • Quick processing of follow-up loans	• Limited range of loan conditions • Rotating access to credit • Various types of loans	• Group loan is aggregate of individual loans • Loans disbursed in cycles • Rigid loan conditions	• Varied loan amounts available to individuals
Guarantees	• Collateral and/or cosigners	• Mutual guarantee of all loans	• Mutual guarantee of all loans • Emergency fund	• Peer pressure from group • No guarantees on individual loans	• Guarantees on individual loans at discretion of group
Savings	• Not essential	• Often key to methodology	• Key part of methodology	• Essential part of methodology	• The fundamental principle of the methodology
Group Characteristics	• None	• Self-selected small groups	• Self-selected small groups • Formation of federations of groups • Required attendance at weekly meetings	• Democratic control • Administratively self-sufficient • Independence • Autonomy in member selection • Regular meetings	• Democratic control • Administratively self-sufficient • Independence • Autonomy in member selection • Regular meetings • Formation of federation of groups

A Microenterprise Training Guide
for Peace Corps Volunteers

MODULE 3

Operating a Microfinance Institution

Business
Centers
Supporting
Entrepreneurs

MODULE 3

OPERATING A MICROFINANCE INSTITUTION

A VOLUNTEER'S STORY

A Unique Microfinance Institute: The Cultural Bank

In the West African village of Fombori in northern Mali, 100 miles south of the city of Timbuktu, some women's idea of a local museum to preserve their culture and attract tourists evolved into the Culture Bank of Fombori with the assistance of a Peace Corps small business Volunteer. The sustainable Culture Bank didn't happen overnight—it took three years, one failure, and a revitalized plan. The original concept of the cultural museum charging admission to tourists and selling craft items in a museum shop was abandoned because of lack of tourists. The women found it was necessary to involve the whole village, including the village council and the youth, before the project became successful. The museum's board of governance now represents men and women, young and old. Thinking changed from "how can the museum attract outsiders" to "how can the museum serve local residents." What evolved was a unique organization.

The Culture Bank is an entirely new type of institution that combines a village bank with a village museum. The Culture Bank enables local inhabitants to use their culturally and historically important objects as collateral for small business loans. In this way, the cultural assets of the community are transformed into economic assets, and a real incentive for conservation of cultural heritage is created. The objects are researched and organized into a collection that is displayed in the Culture Bank's galleries and used as a tool to facilitate community education and development programs. The interest accumulated from bank loans provides income for the Culture Bank's operation, allowing it to become self-sustaining.

The Culture Bank is also designed to play an educational role in the community by using its income to finance a program of cultural and development activities, such as literacy programs, concerts, theater, and artisans workshops. The large covered porch provides a meeting place for storytelling festivals and wrestling matches. There are activities for all. Women have participated in soap-making classes and men in woodcarving classes. All of these activities equip the community with the knowledge and skills to orchestrate its own community development.

The Culture Bank of Fombori began operations in 1997, and in a year and a half it doubled its initial $400 loan fund through its own activities, achieved more than a 95 percent reimbursement rate, and engaged hundreds of people in its program. People from Fombori and the surrounding areas submitted more than 400 objects, such as masks, sacred statues, clothing, weapons, jewelry, and household items, receiving in return loans of 5 to 40 dollars to begin small businesses. The objects were researched, documented, and organized into a community collection that is presently on display in Fombori.

Four other Culture Banks have now been started in Mali, two with the help of Peace Corps Volunteers.

* * * * * * * * *

These written materials are a guide for your Peace Corps technical training journey. They suggest ways you can learn about microenterprises (microbusinesses) and microfinance institutions (MFIs). When you have questions about what you see or hear, don't forget you have valuable resources available. Discuss these questions with your technical trainer, language teachers, other Peace Corps staff, or your host family. By the time you finish this module you should have the knowledge, skills and attitudes to:

- List the common types of microbusinesses found in your host community and describe the owners' expectations for their businesses.
- Explain how MFIs have adapted mass-marketing strategies to provide savings and credit services to millions of low-income people.
- Explain the importance of building institutional capacity and how links between nongovernmental organizations (NGOs), government organizations, and private businesses strengthen MFIs.
- Discuss, after observing an MFI organization, which microfinance methodology the organization uses.
- Do a SWOT (strengths, weaknesses, opportunities, threats) analysis when provided with information about an organization's internal operations and external environment.

LOCAL MICROENTERPRISES

As you traveled from the airport to your training site and explored your host community, what did you observe about people and their jobs? Do most citizens have formal jobs in factories, offices, or stores, or is there a significant amount of informal business activity going on in the streets or markets? Do those who work in the offices, factories, or stores appear to be better off and better educated than those working on the streets? Are there many people who don't have jobs? Did you see any people working at nonagricultural jobs in rural areas?

Your firsthand observations will likely confirm the following:

- Becoming an employee is not an option for millions of poor people.
- Jobs are not available locally, and there are poor people who cannot afford to move.
- Illiteracy and lack of technical skills limit employability.
- Women often face additional barriers to obtaining a job:
  - — Child care and domestic responsibilities.
  - — Cultural norms in working outside the home or with men.
  - — Gender bias limits the types of jobs available for women.

When jobs are not available, self-employment is often the only option. This has resulted in millions of microenterprises being organized, most operated by one person or an owner and unpaid family members. These tiny informally organized businesses are everywhere. You see their owners vending on the streets, selling fish in the market, engaged in simple agro-processing operations, handicraft production, repair services, furniture making, or perhaps driving a taxi.

Unfortunately, many of these businesses are not very profitable; they are undercapitalized and the owners may lack basic business skills. Owners of these struggling microenterprises and those who want to start a microbusiness are the target customers for microenterprise development projects.

"Know your customers" is standard business advice. Therefore, in Activity 3:1 you are encouraged to visit with microbusiness owners to learn how they operate their income-generating activities, and what challenges they face.

ACTIVITY 3:1

GETTING TO KNOW MICROENTREPRENEURS

In this activity you will learn about microentrepreneurs and potential microentrepreneurs. The more you understand about the day-to-day operations of microbusinesses and the challenges their owners face, the better prepared you will be to assist them.

Arrange to shadow a microenterprise owner for several hours during his or her workday. You may already know a microbusiness in your host community you would like to learn more about; if not, ask your host family or a local friend to introduce you to a microentrepreneur.

During the shadowing experience, ask questions in an appreciative way and, if culturally appropriate, offer to help with the work rather than standing back and observing. Gather as much of the following information as is possible:

1. What is the nature of the income-generating activity? ______________
2. How long has the owner been involved in this business? ____________
3. Is the business active throughout the whole year or only when the owner is not involved in other activities? _____________________________
4. Does the microenterprise provide most of the family's income? ______
5. What does the owner like about his or her business?

   ____
6. How would the owner like to improve the business? _______________
7. Has the owner ever borrowed money for the business? _____________
8. If so, from whom? ____
9. How did the owner learn to operate the business? (For example, was he or she taught by a mother, father, or friend; self-taught; or trained in a course?)

   ____
10. What one change would make the business more profitable? (For example: a larger space to sell in, special equipment, more customers, or a vehicle to transport goods?)

    ____

Continued

Activity 3:1, continued

Thank the microentrepreneur for his or her time. A small thank you gift may be culturally appropriate. Ask your host family or language instructor if in doubt.

Pool the information you learned with that of other trainees to piece together a more complete understanding of microenterprise operations.

- What did several of the businesses have in common?
- What were some differences?
- What did you learn that might be useful during your Peace Corps service in helping to develop microenterprises?

MASS-MARKETING MICROFINANCIAL SERVICES

When you first hear that microfinance institutions (MFIs) charge their clients higher fees than commercial banks, it seems unfair. Why wouldn't an organization whose mission is to help the poor charge a token or at least low interest rates? The answer is MFIs must earn interest and/or fees equal to their operating costs plus the cost of capital and inflation, or they cannot remain in business. If the MFI goes bankrupt it can no longer serve its customers.

It is unethical and inconsistent with an MFI's mission—providing the poor with financial services—to charge higher prices for financial services than are necessary because of bad management. Ineffective management results in higher costs, which are passed along to clients. Ineffective management prevents an MFI from providing ongoing savings and credit services for customers.

MFIs fail, not because of a lack of customers or the customers' inability to repay their loans, but because of inadequate planning and management. Most MFIs were started and are operated by those with social goals rather than financial or business backgrounds. These caring individuals are committed to improving the lives of those they serve, but often they lack the business skills to run a financial institution. In a number of countries, Peace Corps business Volunteers have shared their business skills with MFIs and the customers of MFIs.

MFIs face a formidable challenge: to achieve massive scale, because the potential market is vast, while keeping customer costs low. Only when MFIs are well run do they have the capacity to reach larger and larger numbers of poor clients with quality financial services at a low cost on a sustainable basis.

Although MFIs make micro-sized loans, the successful MFIs are not small businesses! A number of MFIs serve more than 20,000 clients each; two MFIs serve almost 2 million clients each. In 1993, Grameen Bank had 1.6 million members, while The Bank Rakyat Indicia had 1.9 million. Their loan portfolios were US $180 million and US $931 million, respectively. Banco Sol and Actuar Bogotá are newer programs, with 46,000 members (loans US $24.8 million) and 37,000 members (loans US $8.2 million). The credit union system in Cameroon had an active portfolio of US $21 million in 1991 and 20,000 loans. The Small Enterprise Foundation in South Africa started operations in 1991, and by the end of 1993 had nearly 2,000 clients and a loan portfolio of US $200,000.

(Figures from *What Makes Them Tick? Exploring the Anatomy of Major Microenterprise Finance Organizations.* Elisabeth Rhyne and Linda S. Rotblatt. ACCION International. 1994. p. 11.)

What do these successful MFIs have in common?

- High customer volume
- Low operating costs
- Low cost of capital for their loan fund
- Efficient delivery systems.

ACTIVITY 3:2

WHAT MAKES DISCOUNT MASS MARKETING SUCCESSFUL?

Chances are you have shopped at one of the large discount mass-marketing stores in the United States. Reviewing the factors that contribute to the success of these retailing giants will give you some ideas as to how an MFI can successfully implement a mass-marketing strategy for savings and lending services.

How many factors can you think of that contribute to the success of the discount mass-marketing firms?

____

____

____

____

____

____

When you finish, look at the list of factors that contribute to these businesses' success at the back of the module. Did you think of some factors that are not on that list? Of the factors you listed and the ones at the back of the module, check those that are applicable to the mass marketing of microsaving and microlending services.

MFIs' ORGANIZATIONAL DEVELOPMENT

There are core competencies, which are similar to those of a well-run for-profit business, that assure a well-run MFI. Strengthening these core competencies builds the capacity of the MFI, enabling the organization to turn its ideas (mission, goals, and objectives) into action. The process of building an organization's capacity is called organizational development (or institutional development).

Peace Corps Volunteers help MFIs improve operating efficiency by working with management, staff, and the MFI's board of directors. Before the end of this module we will discuss each of the core competencies an MFI must develop to achieve its mission. First, we look at the four key elements of organizational development.

Key Elements of Organizational Development

Process: Organizational development is not static; it is organic and evolving. It affects all facets of an organization and implies learning, adapting, and changing.

Capacity: Organizational development involves human resources as well as organizational structure and systems. Both need to be strengthened in concert.

Impact: Organizational impact is not a goal. It is a means to solve problems and improve capacity that will result in greater impact on the quality of people's lives.

Long-term: The ultimate goal of organizational development is to become a self-reliant organization that can sustain the flow of benefits and services to its members/clients over time.

(Adapted from *An Institutional Guide for Enterprise Development Organizations,* Elaine Edgcomb and James Cawley, Editors. The Small Enterprise Education and Promotion Network (SEEP), New York, 1993. p. 10.)

MFI Goals	Organizational Development	A successful, sustainable MFI capable of achieving its goals has:
1. Serves large numbers of the poor. 2. Provides high-quality financial services. 3. Low costs.	The process of building an organization's capacity to enable it to put ideas into action and achieve the organization's goals.	• Trained staff • Adequate financing • Effective governance and management • Policies and systems to deliver and monitor quality services and costs

ACTIVITY 3:3

MFI SITE VISIT

Visit the sites of some local MFI operations. Find out what is working well. Remember to ask questions "appreciatively." The problems will come out, but let them come out later.

Why did the MFI start operations? ________________________________

What are the strengths of the organization? __________________________

What micro-finance services (savings and credit) does the organization offer?
____

Who are the MFI's clients? ______________________________________

How do they determine if their clients are poor? ______________________

What impact have the financial services had on the lives of clients—on the communities? ____

What interest rate does the MFI charge, what is the length of the loans, and what is the loan repayment rate? __________________________________

What challenges does the MFI face and what are its opportunities?
____

What is the MFI's development psychology—what does it value most about its projects/programs? ____

A major organizational challenge for MFIs is balancing their dual mission—social impact and financial sustainability. The Small Enterprise Education and Promotion Network (SEEP) undertook an extensive study to learn what practices contribute to the operations that enable MFIs to achieve their dual mission. In 1993, they published a framework for organizational development. This framework and materials relating to the framework resulted from the promising field practices of six development organizations (Pan American Development Foundation; Katalysis—North/South Development Partnerships; Opportunities Industrialization Council, International; CARE, Inc.; Plan International; and Opportunity International).

MFIs operate under four different corporate structures:

1. public (government),
2. nonprofit (NGO),
3. for-profit (private business), and
4. cooperative (credit unions).

Bank Rakyat Indonesia is a government institution and is publicly owned. NGOs offering financial services, while covering their costs, are the most common corporate structure. There are two types of for-profit MFIs—commercial banks and finance companies that move down market to serve the microenterprise sector and NGOs established as regulated financial institutions. In credit unions clients are the owners; excess profits, if any, are returned to the members of the credit union. Surprisingly, organizational development is similar for all four corporate structures.

The SEEP framework identifies four components of an institution: vision, capacity, resources, and links. Each of the four is discussed during three development stages of the organization: the development stage, the sustainability stage, and the expansion stage. Here we will discuss only the components in the development stage. The sustainability and expansion stages are beyond the scope of these materials introducing Volunteers to MFIs.

Vision is the ability to articulate and foster commitment to the mission and the approaches an organization uses. It is important that vision grow out of, and respond to, how local people want to change their lives. The vision is often articulated in a mission statement. A mission statement describes: whom the organization serves, what type of services they will receive, where the clients are located, and how they will be served. Part of the vision should indicate the desired level of impact.

Example of an MFI Mission Statement:

Our mission is to improve the economic well-being of 30 percent of low-income women and their families in the region of Zambuko.

The Zambuko Village Bank provides, through solidarity groups, opportunities to accumulate savings and acquire microloans to start or expand individual or cooperative businesses.

Capacity is the ability to turn thinking into action. Capacity requires an organizational structure through which people can channel their energy and creativity.

Example of an MFI Organizational Structure

BOARD OF DIRECTORS

(Diversified 5–15 member board, including members with financial and technical expertise, women, and clients)

EXECUTIVE DIRECTOR

(Desirable qualities: commitment to the organization; charisma; combination of social commitment and management skills; demanding of excellence in themselves and others)

STAFF

Marketing	Financial	Support
Supervisors and Field Agents	Head Credit Officer and Accountant	Fundraising Officer and other Support Staff

(Staff with appropriate training and clearly defined responsibilities.)

CONSTITUENT ASSEMBLY (CLIENTS/CUSTOMERS)

(Represents group targeted in MFI's mission statement)

* * * * * * * * *

An MFI's leadership is composed of the board of directors and the executive director.

An active board of directors is important because the board:

- Provides a locus for the vision of the organization;
- Develops and approves organizational policies and goals;
- Guides strategic planning;
- Ensures excellence among management and staff;
- Hires and terminates, if necessary, the executive director;
- Oversees accountability of the organization funds;
- Creates links to other key organizations;
- Raises funds and other resources, and
- Provides legitimacy to the organization.

The **executive director** works with the board and implements the board's policies on a daily basis.

An MFI needs **systems and procedures** to ensure that the structure operates smoothly; that there is a timely flow of accurate and complete information; that staff and clients are treated fairly and justly. These include personnel policies, management information systems, budgeting and accounting systems, and monitoring and evaluation systems.

An MFI's **methodology** allows the organization to carry out its mission and achieve its desired outcomes. An MFI's methodology includes target population, desired effect (jobs, income, goods or services produced), mode of organizing clients (solidarity groups, credit unions, etc.), credit policies, services offered (savings, credit, business training), and a set of policies for providing services.

A reminder related to MFI methodology: Experience shows that the poor are willing to pay high interest rates. What is most important to them are quick, easy loans, available close to where they live (they often do not have access to transportation), and with no collateral required to secure the loan.

Resource capacity targets both acquiring and managing MFI funds. For MFIs, key factors include fundraising policies and practices, financial projections, cash flow, and credit portfolio management. Internal controls, internal audits, and an annual audit by a qualified accountant with financial institution experience are necessary to assure both donors and clients of the proper use of MFI funds.

MFIs need money to cover operating costs and for their loan fund. MFI field staff engage in hundreds of small transactions each week, as they collect savings and loan payments and fees, and disburse loans and savings withdrawals. Cash flow management is critical. One way MFIs keep transaction costs low is by keeping the accounting simple.

Keeping Accounting Simple

Loan interest is calculated using a flat interest rate:

Amount of the loan x Interest rate x Length of loan = Total interest.

If the loan in paid back in installments, the real (effective) interest rate may be almost double the stated interest rate.

Sound financial management is critical. To keep client costs low, the cost of capital must be minimized and excess funds invested to earn a high rate of return while keeping the invested funds safe.

Links are productive relationships with a wide variety of organizations and agencies. Establishing links serves three important functions: strengthens organizational capacity, influences policy, and increases legitimacy of the MFI within a community. Links can include relationships with similar MFIs, commercial banks, government institutions, and networks of organizations with similar interests.

(The above information on organizational elements summarizes material found on pages 11–16 of *An Institutional Guide for Enterprise Development Organizations.* Editors Elaine Edgcomb and James Cawley, The Small Enterprise Education and Promotion (SEEP) Network, New York, 1993.)

* * * * * * * * *

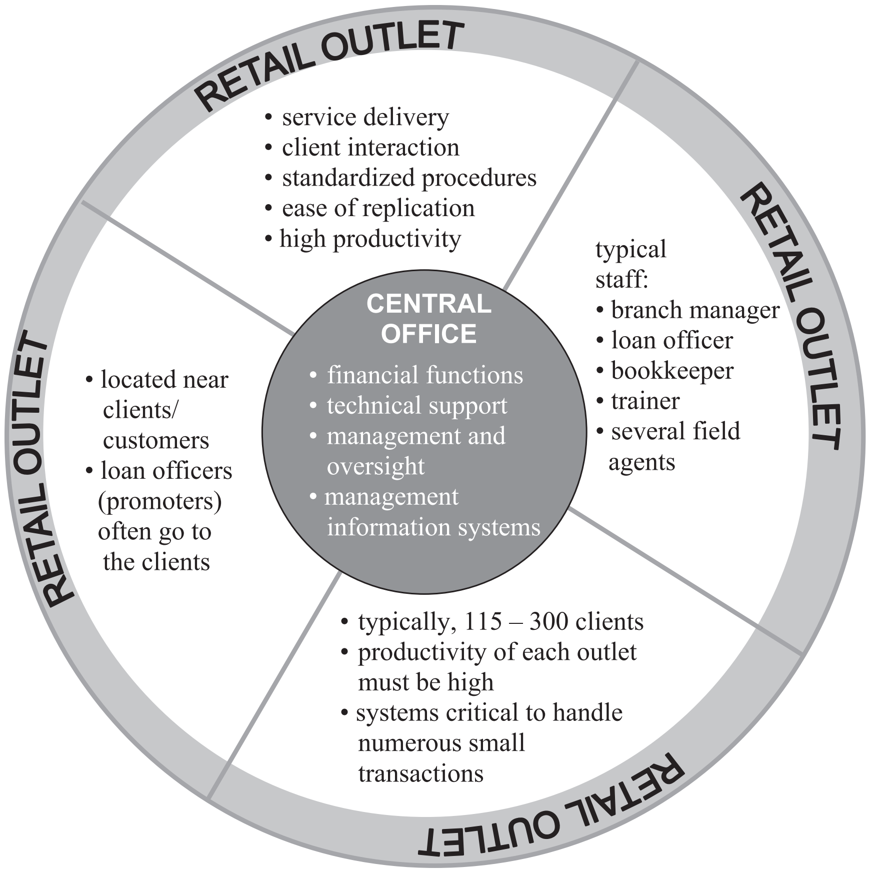
Each element represents a distinctive organizational capacity and involves an integral set of roles, policies, procedures, and tasks that need to be accomplished in systematic and recurring ways.

Competent organizations have a strong sense of mission, and their basic credit and savings services are complemented by other services as an outgrowth of their vision. Their services are highly valued by clients and appear to make a significant difference in the lives of microentrepreneurs' families.

Geographically, MFIs often look something like a wheel, with the central office in the center and retail operations at the ends of the spokes (see the example on the next page of an MFI with four retail outlets). The geographical distribution of large MFIs reveals a simple pattern: a set of small retail outlets that do the frontline work, linked by a superstructure that provides higher-level services and oversight to the retail outlets. A strong model for retail outlets is key to successful expansion—growth comes from replication of standardized retail units.

Geographical Structure of a Small MFI

(Each retail outlet shows a few of the desirable characteristics of MFI retail outlets.)



Financial services for the poor must be located close to clients, whose ability to spend time and money obtaining financial services is limited. Given the expense of making very small loans and taking in small savings deposits, it is essential for each retail outlet to be highly productive. MFIs hire as field workers young, (and usually) secondary school graduates and train them in the field. Pay rates are relatively high compared with other jobs these young people could obtain. Bonuses are common rewards for meeting goals.

MFIs must protect themselves against various forms of fraud—most MFIs encounter fraud by employees at some point. A good internal control system lowers the possibility of funds being misappropriated.

Well-run MFIs have some commonalities. These include strong and stable leadership (i.e., active boards, multitalented and committed executive directors, and senior managers able to take on increasing levels of responsibility). These institutions take a systematic approach to policymaking, vesting the responsibility in more than one person, and making policy changes through formal channels. Growth and innovation are carried out in a highly systematic fashion. The institutions move carefully through product identification, delivery system design, and full implementation.

Looking at the elements of an MFI that have to run smoothly, it is obvious there are a variety of skills and talents the organization must acquire. Most likely the management and staff will not have all of these skills, especially in a small organization. There are several options for acquiring access to missing skills:

- Hire a consultant(s).
- Exchange or borrow personnel with/from another MFI or NGO on a short-term basis.
- Find a local volunteer willing to donate his or her time and talents.
- Use the skills of a Peace Corps Volunteer.

As you were reading about organizational competencies, you may have thought, "I know how to do that!" Do you know about accounting or finance? Can you help staff learn to use computers or set up simple systems on the computer? Are you someone who is good at organizing and writing materials and could help with promotional materials or grant proposals? Are you good at networking? If so, you could assist an MFI in developing cooperative relationships with other organizations and agencies—links. Are you a trainer who could help by developing materials and training clients in very fundamental business management skills, health, or other areas? Are you good with people and could help by recruiting and training local volunteers or helping with board development? MFIs have a big job to do in helping to reduce poverty and empowering people to change their lives. No doubt you can help in a number of ways.

ACTIVITY 3:4

SWOT ANALYSIS USING AN MFI CASE STUDY

Identifying the strengths and weaknesses that are internal to an organization and the opportunities and threats in the organization's external environment is a time-tested tool to ensure a balanced look at both the positives and negatives internal and external to the organization. Examples include:

Strength—an extremely competent executive director.

Weakness—an inadequate accounting system.

Opportunity—a large, underserved target group for your services.

Threat—an inflation rate of 60 percent.

SWOT analysis is a quick, easy way to communicate an overview of the organization and its operating environment.

Below is a case study for Callow MFI. Organize your SWOT analysis as shown below.

SWOT ANALYSIS

Callow MFI

INSIDE THE ORGANIZATION	OUTSIDE THE ORGANIZATION
Strengths	Opportunities
1.	1.
2.	2.
. . . . .	. . . . .
Weaknesses	Threats
1.	1.
2.	2.
. . . . .	. . . . .

You can do the SWOT analysis alone or in small groups. Either way, after you have completed the SWOT analysis, compare and discuss your SWOT analysis with others in your training group. Language instructors or Peace Corps staff may provide insights into the local environment you were unaware of.

Continued

Activity 3:4, continued

If you were asked to advise Callow's board of directors on actions to be taken following your SWOT analysis, what would be your advice?

The following Callow MFI case study is purely fictitious, but it draws on situations observed in a number of MFIs. This case study has been prepared as a training tool to highlight certain organizational development issues faced by MFIs.

The case study provides the information you need to complete the strengths and weaknesses part of the SWOT analysis. You are to use conditions in your host country and local training area as the external environment for the Callow MFI.

Callow MFI Case Study

Callow was incorporated in early 1990 as a not-for-profit charitable organization committed to supporting microenterprises in <u>insert the name of your host country</u>. Callow operates a solidarity group lending service, targeted at market vendors and other midsized microenterprises. In the early years Callow also operated technical and business training activities. These were wound down in 1994 to concentrate resources on the credit activities.

Callow's board of directors is comprised of the founder and chairman, a Christian bishop, and three other individuals: a lawyer, a retired banker, and a mining company executive. The lawyer and the mining company executive travel extensively and are rarely able to attend the meetings.

Sixteen people, including the executive director, who has held that position for seven years, work in the head office. Staff turnover is low. Callow's only office is in the capital city. Field agents sometimes must travel three hours to reach the head office from their most distant solidarity group. In the past, branch offices have been considered, but the board fears a loss of centralized control.

The 100 field agents are committed to excellent client service and spend long hours on public transportation visiting groups, and filling out paperwork and taking it to the head office. All field agents have a minimum of two years of college training, with either a business or a social sciences major. Field agents are hired straight from college and given two months of training. Approximately one in five trainees does not pass/complete the training period; another one in five does not complete their first six months of work. Twenty-five of the 39 loan officers are women.

Continued

Activity 3:4, continued

Field agents' job descriptions are clearly written, and supervisors submit performance appraisals every six months. Supervisors are trained in how to provide effective feedback. Basic salary for field agents is $300 per month. They also receive an incentive payment, and they are paid quarterly, based on the total interest generated by their solidarity group member's loans.

First-time loans begin at $80 per group member and increase in increments of no more than 30 percent per loan. First and second loans must be for a term of four months; subsequent loans may be for four, six, or nine months. Loans are repaid either weekly or monthly, depending on the type of the borrower's business. Interest rates are set each January 1st at 20 percent over the country's inflation rate. Clients pay no other fees. The default rate is less than 3 percent.

About 20 percent of the members drop out of the group after one loan cycle. Only 30 percent of members remain at the end of three years. Field agents constantly have to start new groups to keep their numbers up. Currently only women are allowed to join the solidarity groups.

Financial statements are produced and audited annually. The auditor is a longtime acquaintance of the managing director who provides his services at a highly reduced rate. Other clients of his auditing firm include three hospitals, an advertising firm, several law firms, and several retail establishments.

No annual budgeting or longer-term financial forecasting has been done to date; the board is concerned that not enough loan capital is in place to fund expected growth. The loan portfolio is expected to rise to $1.8 million in the next six months, a growth of half a million dollars, but only $236,000 of the expected growth has been secured from a single donor. Every workday extra cash is deposited in the First National Bank of <u>name of your host country</u>. Only enough cash for the next day's operations is kept in Callow's safe.

A Bad Debt Report is produced monthly. No Portfolio Aging Report is available, so it is difficult to calculate the true "risk" inherent in the portfolio at any point in time.

Possible recommendations for the MFI's board of directors are found at the end of this module.

KEY TERMS

Key terms are defined as they are used in the module. A _space_ is provided to write the local language translation of the word or phrase. We encourage you to work with your language instructors to translate these terms into the local language.

Default: A defaulted loan is a loan the MFI is quite certain will not be paid back the borrower.

Capital: The organization's capital is the amount they have borrowed plus retained earnings plus any donated capital.

Cost of capital: The amount an organization has to pay for the capital it has borrowed plus the amount it would have to pay for donated capital if it were borrowed at the current market rate of interest.

Effective interest rate: Interest rate reflects all costs of the loan fees plus interest paid only on the amount of the loan outstanding. The effective interest rate is sometimes called the "true" interest rate.

Flat interest rate: The interest rate is fixed over the term of the loan.

Institutional (also known as organizational) development: The process of building the capacity of an institution or organization.

Loan fund capital: The amount of capital the entity has that is to be used to lend to borrowers.

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RESOURCES

An End to Debt: Operational Guidelines for Credit Projects. (UNIFEM.) 1993. 104 pp.

Provides guidelines to assist in establishing, managing, and supporting successful credit projects for women microentrepreneurs. Also relevant for microentrepreneurs in general. Clearly illustrates the stages of a successful credit program, from laying out the policies, to identifying a project, planning, implementing, and following up to assure its sustainability. Written from an economic perspective, this project outline is helpful for organizing a credit program for women. A good guide for Volunteers working with women and credit, providing a practical discussion of the issues and strategies involved.

An Institutional Guide for Enterprise Development Organizations. Elaine Edgcomb and James Cawley, Editors. (The SEEP Network.) 1993. 200 pp.

A guidebook prepared by members of the Small Enterprise Education and Promotion (SEEP) Network's Institutional Development Working Group to assist private development organizations plan and implement small enterprise development programs. Deals particularly with the objectives of sustainability, instructional development, and expansion, addressing the questions that organizations need to consider at each stage of a program's development. A tools section contains a variety of forms, sample documents, question guides, and other materials to help in the various planning and implementation processes (e.g., creating boards of directors, hiring staff, arranging contracts, and establishing credit mechanisms); also includes a bibliography and glossary.

Banking Services for the Poor: Managing for Financial Success—An Expanded and Revised Guidebook for Microfinance Institutions. Robert Peck Christen. (ACCION International.) 1997. 274 pp.

Designed to help microfinance program administrators manage for financial success and ensure the sustainability and outreach of their institutions. Focuses on the financial criteria and techniques that are most helpful to managers who want to improve their institution's performance. Summarizes the four major challenges faced by microfinance institutions, as well as the levels of cost recovery. Includes models for financial projections that accompany strategic financial plans.

Juhudi: Credit Officer Training Manual. Kamau Kabbucho and Nanette Magnani. (Kenya Rural Enterprise Programme.) 1993. 393 pp.

"Juhudi," a Swahili word meaning determination, is the name given to a program for providing small loans to microentrepreneurs in Kenya. This publication serves as a training manual for Juhudi credit officers, and provides numerous tips and applications. Offers practical "how-to" information for Volunteers working in nongovernmental and voluntary organizations that are trying to start or strengthen credit delivery systems.

MicroStart: A Guide for Planning, Starting and Managing a Microfinance Programme. (UNDP.) 1997. 157 pp.

Practical, clearly written book that lays out how to start a microfinance institution. Developed as a means to help organizations and individuals who wish to initiate or strengthen their microfinance programs. Compilation of materials useful for Volunteers who are assigned to help nongovernmental organizations in dispensing credit.

An Operational Guide for Micro-Enterprise Projects. (ACCION International/ The Calmeadow Foundation.) 1988. 98 pp.

Based on the experience of organizations affiliated with ACCION International, this book provides a guide for planning and implementing microenterprise assistance programs, focusing on three types of assistance: credit, management training, and how small business development can be supported through training and connections with microloan funds. An excellent source for small business programming possibilities.

Internet:

www.mip.org

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ACTIVITY 3:2 Sample Responses

FACTORS THAT CONTRIBUTE TO DISCOUNT MASS-MARKETERS' SUCCESS

- Focused business plan.
- The firms know their customers and stock what the customers want.
- Products are available when the customers want them, just-in-time inventory.
- Stores are open when customers have time to shop, 24 hours a day at some stores.
- Stores hire local people, and store employees are encouraged to be active in the community.
- Although employee wages are low, the company may show employees are valued through such means as referring to them as "associates" rather than sales clerks.
- Firms use technology to make systems more effective and cut costs.
- Low overhead—stores not located in high-rent districts.
- Good marketing to let customers know the benefits of shopping at a discount store with a wide variety of merchandise and convenient parking.
- Firms practice smart management of debt and equity financing to keep cost of capital low.
- Firms practice long-range planning—they have a growth plan for where and when new stores will be opened.
- Management is experienced in the business of mass retailing.

ACTIVITY 3:4 Sample Responses

POSSIBLE ITEMS TO INCLUDE IN THE STRENGTHS AND WEAKNESSES PORTION OF THE SWOT ANALYSIS

Strengths:

- MFI charges what appears to approximate a market rate of interest.
- Low staff turnover.
- Good personal evaluations.
- Pay incentives for field agents.
- Ratio of head office staff to field staff looks reasonable.
- Low default rate.
- Financial statements are audited.
- Most funds kept in bank where safe.
- Women are well represented in the field agent staff.

Weaknesses:

- We aren't sure, but there may be no women on the board of directors.
- No client representation on the board.
- Board seems small for this large an operation.
- Board attendance at meetings is low.
- Client defection rate seems high.
- Lack of long-term planning.
- Expected increase in demand for loan capital not fully funded.
- Loan officers are spending a lot of their valuable time traveling to and from the head office.
- Though the auditor's price is low, he may not be independent or have the industry expertise needed to do a good job.

Recommendations for the board:

- Expand the board, include women; businesswomen would be a nice addition, as would a couple of clients and someone from another NGO's management.
- Immediately work with the staff to start a long-term planning process; evaluate if opening a branch office now would be a good option given the expected growth.

Continued

Activity 3:4, Sample Responses, continued

- Hire an independent auditor with experience auditing financial organizations.
- Survey clients who have left the solidarity groups to determine why they left and then look for ways to modify the loan product to retain these clients.

TRAINER'S NOTES

MODULE 3
OPERATING A MICROFINANCE INSTITUTION

Overview:

The goal of this module is to train participants to develop an understanding of the MFIs' potential customers. Next, the principles of MFI management are related to the readers' experiences with U.S. mass retailers. The factors that contribute to a mass retailer's success have much in common with factors that contribute to successful and sustainable MFIs. Finally, training participants take a look at organizational development and building the organizational capacity necessary to support microfinance programs.

Time:

Reading 1 hour
Activities 10 hours

Materials:

If international organizations such as CARE, World Relief, PLAN, etc., are operating microfinance institutions in the country, provide information on their methodology to the trainees.

Preparation:

Preparations for a field trip to an MFI may be necessary if one is not located near the training community where training participants can make the arrangements themselves.

Debriefing the experience and processing the learnings:

Important learnings in this module are the general organizational structure of an MFI and monitoring operations to assure quality. By the end of the module, a participant should begin to visualize how his or her individual skills and talents might be used in microenterprise development activities to reduce poverty and improve families' standard of living.

TRAINER'S NOTES

ACTIVITY 3:1
GETTING TO KNOW MICROENTREPRENEURS

Overview:

This activity is designed to equip trainees with an understanding of how microbusinesses operate before they begin working with these businesses or organizations that assist in the development of the microenterprise sector.

Time: 4 hours (approx.)

Materials:

Trainees will probably have questions concerning local microenterprise legal, tax, and licensing requirements. An effective way to gather this information might be to ask one or two trainees who have a special interest in this area to gather the information. They could then summarize the information and present it to the rest of the trainees.

Preparation:

Make trainees aware of any cultural norms or local conditions before they spend time with a microenterprise owner. Depending on the situation, the activity's questions may need to be translated into the local language and/or the trainees should practice the vocabulary. If it is necessary for language teachers to translate, trainees may need to be grouped during this activity.

Debriefing the experience and processing the learnings:

Expand the discussion of individual microenterprises to emphasize the role microenterprises play in delivering goods and services in the local economy:

1. What percentage of families in the community depend on microenterprise activity for their income?
2. What percentage of the goods and services consumed in the community are provided by microenterprises?

The changes that owners would make to improve profitability provide Volunteers and their Counterparts with clues as to how they can intervene to assist microentrepreneurs.

What were other things trainees learned from the shadowing experience? How do these learnings better prepare them for Peace Corps service?

TRAINER'S NOTES

ACTIVITY 3:2
WHAT MAKES DISCOUNT MASS MARKETERS SUCCESSFUL?

Overview:

This activity assists training participants in building an understanding of MFIs' operations based on their past experiences with mass-marketing retailing in the United States.

Time: 30 minutes

Materials:

None in addition to those included in the module.

Preparation:

None.

Debriefing the experience and processing the learnings:

A major lesson to be learned from this mass-marketing activity is that MFIs must operate like mass-marketing businesses if they are going to succeed in helping ever-increasing numbers of poor families improve their economic well-being and family's security.

Suggested responses to the question concerning a discount mass-marketing firm's success:

- Focused business plan.
- Firms know their customers and stock what the customers want.
- Products are available when the customers want them, just-in-time inventory.
- Stores are open when customers have time to shop, 24 hours a day at some stores.
- Stores hire local people, and store employees are encouraged to be active in the community.
- Although employee wages are low, stores can make their employees feel valued by referring to them as "associates" rather than sales clerks.

Continued

Trainer's Notes, Activity 3:2, continued

- Firms use technology to make systems more effective and cut costs.
- Low overhead—stores not located in high-rent districts.
- Good marketing to let customers know the benefits of shopping at the discount stores, low prices, wide variety of merchandise, and convenient parking.
- Firms are smart in the management of debt and equity financing to keep cost of capital low.
- Firms engage in long-range planning—they have a growth plan for where and when new stores will be opened.
- Their management is experienced in the business of mass retailing.

TRAINER'S NOTES

ACTIVITY 3:3
MFI SITE VISIT

Overview:

This activity provides training participants with an opportunity to observe an MFI's operations.

Time: 3–4 hours

Materials:

None in addition to those included in the module.

Preparation:

If trainees cannot arrange visits to an MFI themselves, arrange for field trips to MFIs. Ideally, trainees should visit their offices and observe a field agent working with a group. You may want to divide participants into small groups to visit different places and report to the other groups.

Debriefing the experience and processing the learnings:

Use your local knowledge to help ensure participants gather accurate information. The language instructors may need to become involved to act as interpreters and provide cross-cultural insights. When you visit an MFI make mental notes of which capacities the MFI is implementing well and which could be improved. How would the improvement of the capacities you identify contribute to the MFI's ability to provide low-cost loans and make savings programs available to large numbers of low-income people?

The major learning from this activity is an understanding of how an MFI operates and who is involved in the process of issuing a loan or the acceptance of a saving deposit.

TRAINER'S NOTES

ACTIVITY 3:4
SWOT ANALYSIS

Overview:

This activity is designed to acquaint or reacquaint trainees with SWOT analysis, a systematic approach that looks in a balanced way at the internal strengths and weaknesses and external opportunities and threats facing an MFI.

Time: 1 hour

Materials:

Description of SWOT analysis and case study included in the module.

Preparation:

Familiarize yourself with the case and be prepared to answer trainees' questions related to the opportunities and threats found in the host country.

Debriefing the experience and processing the learnings:

This is an opportunity for discussions with training participants about factors affecting local economic conditions, which they may not have noticed. Focus on effects of these factors on microenterprises as well as on the MFIs.

Possible items to include as strengths and weaknesses in the SWOT analysis:

Strengths:

- MFI charges what appears to approximate a market rate of interest.
- Low staff turnover.
- Good personal evaluations.
- Pays incentives for field agents.
- Ratio of head office staff to field staff looks reasonable.
- Low default rate.
- Financial statements are audited.
- Most funds kept in bank where safe.
- Women are well represented in the field agent staff.

Continued

Trainer's Notes, Activity 3:4, continued

Weaknesses:

- We aren't sure, but there may be no women on the board of directors.
- No client representation on the board.
- Board seems small for this large an operation.
- Board attendance at meetings is low.
- Client defection rate seems high.
- Lack of long-term planning.
- Expected increase in demand for loan capital not fully funded.
- Loan officers are spending a lot of their valuable time traveling to and from the head office.
- Though the auditor's price is low, he may not be independent or have the industry expertise needed to do a good job.

Recommendations for the board:

- Expand the board, include women; businesswomen would be a nice addition, as would a couple of clients and someone from another NGO's management.
- Immediately work with the staff to start a long-term planning process; evaluate if opening a branch office now would be a good option given the expected growth.
- Hire an independent auditor with experience auditing financial organizations.
- Survey clients who have left the solidarity groups to determine why they left and then look for ways to modify the loan product to retain these clients.