

**Credit schemes
for the rural poor:
Some conclusions and
lessons from practice**

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Preface

The provision of financial services has been increasingly considered as a major instrument for employment creation aiming at poverty eradication.

For the working poor, most of whom are self-employed - small and marginal farmers, fisherfolk, artisans and craftsmen, petty traders and micro-entrepreneurs in the urban informal sector - the lack of financial resources restricts their ability to expand production or undertake improvements in productivity and income.

Being more than only an instrument to raise incomes and secure sources of employment, credit services for the poor are also means of empowering the poor. Armed with the economic capacity to obtain goods and services that credit services provide, the poor have a stronger bargaining power when negotiating and dealing with other interest groups in a society.

Hundreds of small farmer credit programmes were established in developing countries during the last four decades as a way to modernize and expand agricultural production and to improve levels of living in rural areas. During the past two decades, an increasing number of special credit schemes have been set up in relation to or as part of special employment schemes, income-generating projects and micro-entrepreneurship development programmes.

The International Labour Organization itself has carried out work in the area of credit services for the poor in relation to its efforts to enhance the employment creating potential of the informal and small-scale sectors, and to improve the income-earning capacities of rural workers and of vulnerable groups such as female heads of households, women homeworkers and refugees.

Given the failure of formal financial institutions to reach the poor and the limitations of informal sources of credit on which the poor largely rely, special credit schemes have been introduced over the past years. A wide variety of alternative credit programmes have been developed and tried, using different modalities of operation and institutional arrangements. Some work within the formal financial sector, some are linked to it, others operate outside and parallel to it. Several successful experiences have emerged, but many have also failed to meet expectations. For future work in the area of credit services targeted at the poor, it is important to undertake a regular assessment of experiences from which one can draw practical guidance.

The paper by S. Tilakaratna commissioned by the ILO, focuses on the evaluation of credit schemes for the rural poor. On the basis of selected practical experiences, the paper examines several key issues that currently confront special credit schemes - role of mobilization of the poor in credit provision, link of credit with savings, minimization of transaction costs, minimization of loan delinquency and defaults, interest charges and viability and draws valuable lessons for future planners of credit schemes. It debunks some major assumptions about the poor and credit for the poor which have led to the design of unviable and ineffective credit schemes. It looks into the issues related to credit for rural women and addresses the question of the need for targeted credit for the poor.

It is hoped that this paper makes a contribution towards the rapidly evolving debate on financial services to the poor.

The author is a distinguished Sri-lankan Scholar and University Professor. This paper was initiated by and carried out under the general direction of Azita Berar-Awad.

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I. THE MAIN REPORT

1. Introduction

Provision of credit is increasingly being looked upon by development agencies as an important instrument in dealing with poverty in both urban and rural sectors. Specifically, in the efforts to promote micro-enterprises, self-employment and income generating activities among the poor, credit is often considered a critical input. The learning effects of skill transfer and training activities (which form an important component in many an externally-funded technical cooperation project) cannot by themselves translate into higher productivity, incomes and employment for the poor without a simultaneous improvement in the latter's access to credit.

Credit is much more than just another input such as fertilizer or improved seeds. It is a *command over resources*; an instrument which enables a person to obtain access to or extend control over resources. Being a generalized claim on goods and services, credit has the potential to improve the bargaining power of the poor in their dealings with other groups in a population. Hence, access to credit is also considered an important factor in development approaches that seek to *empower the poor*. The role of credit in development efforts has received renewed focus in more recent years in the context of market-oriented policies and corresponding efforts to promote private sector initiatives, whether as individual enterprises or self-help group efforts. Micro enterprises are being increasingly looked upon as a major development mechanism for income and employment generation among the poor as well as for social stabilization.

The focus of this paper is on credit schemes for the rural poor, which often form an important component of many local-level development projects and programmes sponsored or promoted by international agencies. The rural poor would include in addition to the legion of small and marginal farmers, landless workers and the growing numbers of individuals engaged in 'off-farm employment', the micro-entrepreneurs engaged in trading, cottage industry and numerous services, often in the informal sector. Women from poor households constitute a large portion of such micro-entrepreneurs in many countries.

This study is in two parts: Part I is the main report which seeks to present conclusions and lessons emerging from a study of practice - that is the operation of a number of rural credit programmes in different countries. Part II presents case studies of three of the more successful and well-known programmes (i.e. Grameen Bank of Bangladesh, Production Credit for Rural Women in Nepal and BKK in Indonesia) and two ILO-supported credit projects (in Sudan and Bangladesh), and experiences of some sponsoring agencies namely USAID, OXFAM and UNDP. Part II, which could stand on its own, is meant for those who are interested in some concrete cases and experiences.

2. Rationale of Special Credit Schemes

2.1 Formal and informal finance and financial dualism

Formal commercial finance: Ideally the credit needs of rural poor should be met by commercial banks or other specialized financial institutions that operate in the national mainstream of a country - that is, by formal finance. The rationale of special credit schemes for the poor arises fundamentally from the failure of the mainstream financial institutions to serve the poor. Formal finance considers lending to the poor as too risky (high default rates) and expensive (high transaction costs). Stringent collateral requirements of formal lending institutions often rule out a large segment of the population from access to credit. Quite commonly, they prefer to deal in large sums creating a preference for large and medium enterprises (as against small and micro enterprises), higher income households (as against the poor households) and bigger farmers (as against small and marginal farmers and landless workers). In general, formal financial institutions are overwhelmingly urban-oriented from the point of view of both the distribution of branch network over the national territory and the concentration of their deposit-lending activities. The objectives, organizational structure and lending procedures severely restrict the ability of formal institutions to service the credit needs of the poor.

Formal cooperative finance: Among the earliest responses to this problem were governmental interventions to set up formal cooperatives to service the credit needs of the poor - either full-pledged credit cooperatives or adding a credit function to multi-purpose cooperatives. Government funds as well as bank credit were channelled to the rural populations through cooperative societies. In general, however, the success of government-promoted formal cooperatives in serving the poor has been rather limited and fallen far short of expectations, and this is for a number of reasons. Firstly, the government-promoted cooperatives have often failed to develop a people's movement of voluntary and democratic institutions; they lacked a popular base, and government control over them continued to be an important feature. Secondly, in communities characterized by socio-economic differentiations, leadership positions of cooperatives fell into the hands of the local elite, and the poor were

marginalized in the process. Thirdly, compared with the interests of the small farmers, the interests of the most deprived such as the landless and the marginal farmers as well as the special interests of women had not been adequately addressed by cooperative credit. Fourthly, because of political interference as well as the failure to adopt innovative methods, high default rates have characterized the credit operations of cooperatives in many countries requiring heavy dependence on government funds to make good the erosion of funds due to defaults. Finally, low level of participation of the members, corruption and malpractice have commonly figured in cooperative societies. All this should not imply that attempts to channel rural credit through cooperatives have been a failure everywhere. There are notable exceptions of success stories virtually in every country; but in general, cooperatives have failed to make a dent on the problem of credit to the rural poor. Recognizing these deficiencies, many countries have attempted to introduce reforms such as to free cooperatives from government control and give more autonomy, and to enable the cooperatives to draw their membership from homogeneous socio-economic groups such as the landless or women instead of mixed membership.

Informal group finance: On the other hand, the most common responses of the rural poor to their marginalization (from the mainstream credit) has been to 'turn inwards', that is to take initiatives to mobilize their own resources (however small the possible magnitudes be) as a method of meeting their credit needs and of reducing their dependence on the outside. These initiatives are in effect coping strategies, and mutual support and solidarity mechanisms that people themselves have evolved in response to their marginalization. These include rotating saving and credit groups, informal savings clubs and mutual aid groups, all of which are informal arrangements of one kind or another, hence may be termed 'informal group finance'. All these methods derive their loanable funds from the savings, subscriptions (shares) and membership fees of the members, and the funds so collected are given out as loans to members on the basis of a commonly agreed set of rules. In many rural communities in developing countries, informal group finance plays an important role in meeting the credit needs of the poor such as survival needs, working capital needs of micro businesses, and unforeseen family expenditures. In some communities, these may be the only sources of credit available to the poor. Informal group finance are often buffering mechanisms which help reduce the fragility of economy of poor rural households and provide a measure of stability to them in the face of crises of one type or another that they have to cope with (e.g. a harvest failure, loss of employment, a death or illness in the family). More over, besides the saving-credit dimension, these informal group arrangements also have an important social dimension namely solidarity, self-help, and collective decision making and management.

Informal group finance, while important in many rural communities, has not attained a scale and a coverage to make a significant impact on the credit problem of the rural poor. For one thing, the bulk of the rural poor remain an unmobilized mass; they have not taken initiatives of their own for informal group finance. For another, even where initiatives for informal group finance are an important feature, the resources mobilized by the poor through their own savings have not been of a sufficient magnitude to meet their development needs, particularly to expand the scale of their on-going micro-enterprises, adopt new technologies or start new enterprises. Quite often informal group credit arrangements do no more than meet the credit needs of survival, unforeseen household expenses and some of the working capital needs of existing family enterprises. They are of marginal importance in the rural finance of many countries.

Informal private finance: The failure of formal finance (including formal cooperative methods) to reach the poor, and the limited expansion of informal group finance, has meant that the majority of the poor continue to fall back on various sources of informal private finance to meet their credit needs, the more important being: (a) non-commercial sources such as friends, relatives and neighbours and (b) professional money lenders, traders, store-owners, output processors and landlords. Of these, money lender-trader-landlord, that is (b) above, is the dominant source in many countries, particularly in Asia.

The financial systems of developing countries are therefore commonly characterized by the co-existence and operation side by side of a formal financial sector and an informal one, a situation commonly denoted as 'financial dualism'. The share of informal credit has been estimated to range from around 30 per cent to more than 80 per cent of the rural credit supply in the developing countries. It has also been estimated that roughly not more than about 5 per cent of all farmers in Africa, 15 per cent in Latin America and 25 per cent in Asia have access to formal credit.¹

¹ Dimitri Germidis, Denis Kessler, and Rachel Meghir: *Financial Systems and Development: What Role for the Formal and Informal Financial Sectors?* (Paris, OECD, 1991), p. 14.

Compared with formal finance, there are many features in informal private finance which make it attractive to the poor. Among these are the following:²

- proximity to borrower's home;
- flexibility of operations and credit terms to meet specific needs and to correspond to the capacity of the client concerned;
- minimal red-tape involved in transactions;
- easily understood rules and regulations;
- rapid processing of requests and delivery of credit low transaction costs for both borrowers and lenders because of the informality of operations;
- transactions are based more on the confidence engendered by face-to-face relationships between creditor and debtor, and pressures to abide by certain rules of behaviour rather than collateral.

In short, flexibility, rapidity, transparency of procedures, personal relationships and low transaction costs constitute the main strengths of informal private finance.

There are, however, many limitations and disadvantages of informal credit, particularly from sources such as trader-money lender-landlord, the more important being the following:

- money-lenders charge very high interest rates on loans which are, quite commonly in many countries, as high as 5-10 per cent per week or up to 20-30 per cent per month. High interest would invariably mean that poor tend to borrow only when it is critical to do so, and borrowings are often restricted to small amounts obtained for brief periods. Such a situation cannot obviously stimulate significant business growth in the micro-enterprise sector nor finance investment in long-term assets. Consequently, there is reason to believe that shortage of investible funds at market rates has been a barrier to the expansion of the micro-enterprise sector and that there is considerable under-investment in this sector relative to the potential opportunities;
- credit provision by money-lenders often involves other obligations such as to buy inputs or consumer goods, or to sell the produce or labour thereby creating opportunities for the lender to impose unfavourable terms of exchange on the borrower. There is often an overlapping of personae of money-lenders, landlords, employers, produce dealers and traders; and in such situations, it would be possible to tie credit supply to operations in produce and labour markets so that all major economic transactions of the borrower operate in favour of the lender;
- finally, loans from informal sources are in general inadequate in scope for development purposes, being often only for short-term purposes and rarely for capital assets, usually for traditional rather than new or innovative activities, and mostly for survival needs rather than for developmental needs.

The challenge is how to achieve an *inter-linkage* between the formal and informal sectors, so that the strengths of the two sectors could be combined to ensure an improved flow of credit to the rural poor. As already noted, while the strength of the informal sector lies in its flexibility, rapidity and low transaction costs in meeting the credit needs of the poor, the formal sector has the capacity to lend considerably more resources (than the informal sector could do) and at lower interest rates. An important issue therefore is how to devise methods to provide better and increased financial services to the rural poor by learning from the experiences of both formal and informal (private and group) finance. The wide variety of rural credit schemes sponsored or implemented by various development agencies are basically responses in one way or another to the above challenge.

2.2 Nature and forms of credit interventions

There is a wide variety of rural credit programmes sponsored or implemented by various development agencies. They differ in the modalities of operation and institutional aspects. Part II of this study includes case studies of some selected programmes which reveal four different types or forms as follows:

Specialized credit institutions such as Rural Banks which have been set up as alternative institutions to commercial banks which have failed to reach the poor. They engage in both saving mobilization as well as lending operations, and could replenish their resources by borrowing from other banks, refinance from central bank and grants from government and donors. They are expected

² See also Chapter 8 of Part II: "*Learning from the Money Lenders*".

to pursue more active and liberal lending policies than commercial banks such as lending without stringent collateral, and for this purpose, to maintain closer relations with potential customers and adopt innovative methods to reach the poor and to ensure loan recoveries. They are also expected to be self-financing in their operations, that is to cover their costs and risks from interest and service charges they earn on their lending operations. Grameen Bank described in Chapter 1 of Part II is one of the more successful cases of such specialized credit institutions, serving a clearly defined target group namely landless rural households using innovative banking methods. BKK (Sub District Credit Institution) in Central Java, Indonesia, which is owned by the provincial government (described in Chapter 2 of Part II) is another example of such a specialized credit institution which uses innovative methods and is also self-financing.

Revolving loan funds (RLFs) set up in banks or similar institutions for lending to specified groups of rural people and on specified terms is another important category. The fund is provided by an outside agency or a particular project which also lays down the criteria of lending and other operational modalities. The transaction costs of lending will be met from the interest charged on loans and any loan defaults are a charge on the capital of the fund. The term 'revolving' has far reaching implications, in particular that the real value of the fund is maintained, and a measure of sustainability is attained. These would require that the fund is able to generate adequate surpluses to cover the cost of administration, allow provisions for default and compensate for inflation. In practice, many RLFs have failed to achieve such sustainability which means that capital in the fund has to be replenished from outside to ensure continuity of operations. The credit programmes of UNIFEM and the project with refugees in Sudan (described in chapters 4 and 7 of Part II) use revolving funds. It may be noted that when a RLF is set up outside and separate from existing financial intermediaries (as in the case of Sudan), sustainability also implies the transition to a viable institution with link-ups with the financial sector.

Credit guarantee funds (CGFs) represent a third category of special credit programmes. In contrast to a RLF, a guarantee fund does not entail a cash transfer from a project or a donor directly or indirectly to ultimate beneficiaries. A guarantee fund is to secure a bank or any other lending institution against the default risks involved in lending to borrowers who cannot mobilize sufficient collateral. The guarantee provided by an outside agency/project could vary from 100 per cent to some partial amount. With 100 per cent guarantee from outside, the lending institution is likely to play only a passive role since it does not have to bear any risks. Women's World Banking (WWB) (described in chapter 7 of Part II), for example, provides only 50 per cent of the guarantee, while the balance is equally shared between the local affiliate of the WWB and the local bank. A CGF that is nothing more than a blocked account in a bank involves little overheads for the donor/project which provides the guarantee. Institutional sustainability would also be easier to the extent that the bank shares in the guarantee and is willing to raise that share progressively over time.

An important declared objective of a credit arrangement such as a CGF is in fact to demonstrate the creditworthiness of the specific categories of borrowers who are marginalized by banks. The bank concerned is expected, after a few years of experience with the operation of a CGF, to increasingly absorb the credit risk and eventually assimilate this category of clients into its general portfolio. The long-term goal is therefore to promote and graduate a target group of people to 'bankability'.³

Intermediation to improve access to credit: The three types of credit programmes described above, namely specialized credit institutions, RLFs and CGFs, are mainly supply-side initiatives to the credit problem of the rural poor. Their focus is largely to improve supply sources and channel credit to specified target groups. On the other hand, there are initiatives which operate primarily on the demand side, that is to promote and stimulate the demand for credit and help mobilize the poor to obtain credit from existing supply sources such as banks through negotiation and demonstration of creditworthiness. The focus is to improve the access of the poor to the existing credit supply sources. This mode of intervention could operate particularly well in situations where there are special credit programmes for the poor but do not reach them for various reasons. What is needed in such a context are measures to improve access to credit rather than create new supply sources. The Production Credit for Rural Women (PCRW) in Nepal described in Chapter 3 of Part II is a good example of such intermediation. Under the Intensive Banking Programme (IBP) of Nepal, it is a legal requisite that a specific amount of funds be loaned to priority activities of which production credit for rural women is one. What the PCRW programme does, is to mobilize and organize women, and link them up to

³ Demonstration of the credit-worthiness of marginalised populations and graduation of such people to 'bankability' is also an oft-cited objective of RLFs.

commercial banks for credit, and to other delivery agencies for technical support and infrastructures. It does so through the intermediation of a specially trained cadre of grass roots workers - Women Development Officers (WDOs).

3. Lessons from Practice

3.1 Mobilization for credit provision

Credit is often viewed as an entry point for initiating development activities among the poor. Experiences however show that provision of credit by itself may not prove effective as an instrument of raising production and incomes of the rural poor, particularly of the bottom poor. Credit may need to be supported by access to improved technology, input supply, infrastructure facilities and markets. Credit alone is a *minimalist approach* which could prove effective only where the poor already have complementary resources or have developed capacities to obtain access to other support services that they require, and where the poor are entrepreneurial and have the capacity to take business risks. Such conditions may hold true for a minority among the poor, namely those more resourceful and entrepreneurial among them. The majority of the rural poor, however, will require an initial capacity build-up or a preparatory phase of mobilization to give them a measure of confidence in their abilities to change their life conditions before they could begin to use credit effectively. Such a preparatory phase would involve many things such as:

- an awareness build-up on the problems of livelihood and the opportunities available for improving life conditions;
- building solidarity groups for facilitating initiatives to create the desired changes;
- mobilizing resources from among themselves; and
- acquiring basic technical and managerial skills.

People who have gone through such a preparatory phase, would have become conscious of the problems and opportunities, and taken some initiatives for changing their conditions using their own resources in the first instance. With such mobilization and preparedness for change, it would now be easier to introduce credit as a method of accelerating their development initiatives.

It is important to recognize that a mobilization as described above rarely springs from the poor themselves as more or less a spontaneous process. The general experience is that the rural poor will need to be assisted to go through such a preparatory phase using a participatory mode of interaction, often called animation-facilitation.⁴ Such mobilization work is carried out by trained grass roots development workers (called by different names such as animators, facilitators, change agents, group organisers and community mobilisers).

Grameen Bank (GB) and Production Credit for Rural Women (PCRW) are two concrete examples, where a preparatory phase of mobilization precedes the provision of credit. In GB, there is an initial period of intensive interaction between the extension workers of the bank and the target groups of rural poor leading to the formation of solidarity groups, building of group savings funds, and literacy training and orientation on credit use. In PCRW, the Women Development Officers who are the frontline workers in the project, assists the poor women to organize themselves into solidarity groups, provides the relevant information, assists in the identification of appropriate productive activities, stimulates in the mobilization of savings, and arranges technical backstopping from delivery agencies. Linking up with banks for the provision of credit takes place after such a preparatory phase. Further more, in both GB and PCRW, the extension workers follow-up on the utilization of loans and loan repayment. The emerging conclusion therefore is that a mobilization process or a preparatory phase is often a prerequisite for the effective use of credit as an instrument of assisting the economic advancement of rural poor. Credit by itself cannot often serve as a ready made entry point.

The need for a mobilization or a preparatory phase has some important implications for the operating costs of credit projects. There is a need to maintain a cadre of grass roots workers who would interact with identified categories of poor, assist in mobilization and organization, facilitate the access to complementary services that borrowers may require for the productive use of credit, and also engage in follow-up action to monitor the use of credit and timely repayment. Provision of credit to the rural poor is therefore a highly labour-intensive process involving mobilization, facilitation and close monitoring. The important question is who should pay for the costs of social mobilization : should such costs be included in the project cost of credit operation to be covered by the interest

⁴ The methodology of animation-facilitation is spelled out in S. Tilakaratna: *The Animator in Participatory Rural Development: Concept and Practice* (Geneva, ILO, 1987).

income of lending (as a self-financing operation) or treated differently? It may be noted here that the work of PCRW in Nepal (operated under the Ministry of Women and Development) is quite distinct from the credit operation handled by the banks. The mobilization and promotional work of PCRW are being funded with grants from several donors. Also given its highly staff-intensive nature of operations, the Grameen Bank has not been able to cover its full costs by the interest income alone although it is charging the market interest rates. Hence, it has to recourse to concessional loans and grants from donor agencies to meet part of its costs. These concrete examples point to the need to keep the promotional costs - of mobilization, facilitation and monitoring - separate from the direct costs of credit operations. While the promotional costs represent a social investment (to be funded by grants), the credit operations as such will need to be viable, hence self-financing.

3.2 *Linking credit with savings*

In general, successful credit programmes have attempted to link credit supply with savings mobilization. What is important is the provision of *financial services* to the poor, that is facilities for *both savings and credit*, and not pure credit. Savings should be looked upon as an organic complement to credit, essential for both the long-run viability of the credit scheme as well as the self-reliance of the borrowers. Absence of such a link is an important factor in the lack of sustainability of many credit projects.

Traditional credit policies have assumed that the rural poor have little or no saving capacities; hence, the attention was focused entirely on lending to the neglect of saving. Over the years, experiences have shown that rural savings are a vast untapped resource potential and that rural poor have much larger saving capacities than usually assumed. The rural households, irrespective of the extent of their poverty, are capable of saving small amounts quite regularly or lump sums during certain period of the year such as immediately after an harvest.

In programmes where savings and credit are linked, a person will need to have some minimum savings to be eligible for borrowing and the loan amount will usually be some multiple of the deposited savings. People's own savings ('inside money') would thus constitute an important source of loanable funds and hence, people will tend to develop a sense of commitment and to have a stake in the credit programme. Recourse to funds from outside ('outside money') would serve to augment basic loaning capacity derived from internal sources. Many of the thrift and credit societies operate on this basis - they rely on inside money as the main source of funds, outside money being only a supplement.

There are other programmes such as the Grameen Bank which, although do not relate the loan amount to savings in a fixed ratio, emphasize generation of savings as a pre-requisite for the provision of credit. Each member must make a weekly contribution of one Taka to the group savings fund, and when taking a loan must contribute 5 per cent of the loan amount to the group fund. Members could borrow from the group fund in time of need at terms agreed by the group and for any purpose including consumption and loan repayment. Further more, it is required that 4 per cent of the loan amount be contributed to an emergency fund to be used as insurance against loan defaults. The BKK in Indonesia (which provides loans on individual rather than group liability) does not offer facilities for voluntary savings, but there is a compulsory saving component varying from 6.5 to 20 per cent of the loan amount, depending on the size of the loan taken.

An important conclusion emerging from practice is therefore the need to establish an organic link between savings and credit.

3.3 *Minimization of transaction costs*

Minimization of the *transaction costs* of lending and borrowing emerges as a critical factor in the success of rural credit programmes. Transaction costs (TCs) for lenders constitute the administrative costs associated with lending, that is costs incurred during the proposal vetting process, including assessment of project viability and applicant references, implementation of loan administration and the institution of loan repayment mechanisms. In general, formal institutions such as banks are impersonal in their operations and depend on various structured information gathering and verification procedures to select those to whom they would lend, and these procedures often require literacy (on the part of the borrower) and collateral and are also time-consuming. Transaction costs to borrowers consist of the expenses of documentation, travel costs and other incidentals, and the earnings foregone during the waiting period (opportunity costs of waiting for a loan) and losses on account of delayed receipt of a loan. The time-intensive nature of borrowing (the time-lag between application and disbursement) and delayed loans ('a loan delayed can often be a loan denied') are often

critical transaction costs confronting the poor when borrowing from formal institutions. Such transaction costs to borrowers could sometimes be much more than the interest cost of a loan.

An important factor in minimizing the transaction costs is the extent to which such costs could be *externalized rather than internalized* by the lending agency. Externalization would mean that these costs are borne by the community or the group from which the borrower is drawn rather than being passed on to the individual borrower. The borrower and the peer/reference group from which the borrower comes participate in the credit programme and even 'own' the programme and take the responsibility for it. The borrowers are collectively selected by the group concerned based on intimate knowledge and are backed up by mutual support and group solidarity. Hence, the extent to which a credit programme is planned and implemented as a collaborative enterprise with the poor becomes an important factor in minimizing the transaction costs. The group liability principle used in both Grameen Bank and PCRW are proven methods of minimizing the transaction costs of both lender and borrower.

As described in Chapter 8 of Part II, informal money-lenders impose little or no costs on borrowers that they cannot collect as direct financial charges. 'There is no application process other than a casual conversation and the loan disbursement often takes place on the same day.' They have a first-hand knowledge of their borrowers and their economic and business conditions. There are some credit programmes (such as the BKK in Indonesia described in Chapter 2 of Part II) which attempt to minimize transaction costs by reliance on character references from recognised persons in the community such as a local priest, a teacher or a government official. This is a 'personal integrity model', where trust is placed in the judgement of the referee. No feasibility studies are carried out of the projects or the purposes to be funded and the one-page loan application is processed in less than a week.

3.4 Minimization of loan delinquency and defaults

The viability of a credit programme requires minimization of loan delinquencies and defaults. Delinquencies are delays in payment resulting in overdue loans which if unchecked could lead to defaults or total non-repayment. There are number of consequences that follow from such a situation:

- it destabilizes the credit system;
- overdue loans raise the cost of administration and defaults push up lending costs without any corresponding increase in loan turnover;
- defaults reduce the resource base for further lending and affect borrower confidence.

Among the more important causes of loan delinquency and defaults which operate at the borrower level are the following:

- unforeseen circumstances such as natural calamities (floods, droughts and pest attacks) or adverse circumstances in the family such as illnesses and deaths;
- failure to generate adequate incomes due to factors such as the absence of supporting services, improper technical advice or inadequate marketing facilities;
- given the low level of subsistence, any additional income generated through loan supported activities tends to be appropriated for urgent basic needs or the loan itself is diverted into consumption;
- borrowers have considered the loan as a grant or have wilfully neglected to repay.

Experiences reveal that group funds, built with contributions from members, is an effective method of dealing with emergency situations such as natural calamities and adverse family circumstances. Resources in group funds are used to repay loans or meet unforeseen expenses such as due to an illness in the family. In the case of the Grameen Bank of Bangladesh, for example, in addition to a regular weekly contribution into a group fund, a member when taking a loan also contributes 5 per cent of the loan amount into the group fund and another 4 per cent into an emergency fund. Members can borrow from the group fund for any purpose which obviates the need to use the loans for consumption purposes. Emergency fund is specifically used to repay loans in unforeseen situations.

On the other hand, a wilful failure to repay (through neglect or considering the loan as a grant) is essentially a reflection of the lack of participation of the people concerned in the credit programme and the existence of a wide distance between the people and the lending agency. Defaults could also occur when the loan is only a one-time affair and there is no possibility of repeat loans. A project that grants a single loan without the prospects of an additional one often tend to have repayment problems. Evidence from many projects show that a major incentive for high loan payback

is the availability of repeat loans, so that the clients begin to think not in terms of an individual loan but of a line of credit - a continued access to loanable funds - to meet the business needs. On the other hand, when the availability of repeat loans is uncertain, borrowers tend to place a low value on a continued relationship with the lending agency.

Experiences also show the importance of building a 'culture of repayment'. Unless quick action is taken when repayment problems occur, loan repayments can sag drastically. Once a person or a group gets away without paying the loan, others quickly begin to question why they should pay. If default is not to spread, rapid remedial action is needed. This issue highlights a critical aspect of the management of a credit programme, that is the will and the effort expended to recover the loans. Experiences also show that group liability and peer pressure are important factors in creating a 'culture of repayment'.

3.5 *Interest charges and viability*

The interest rate charged on loans is an important factor in the long-term sustainability of a credit programme. Quite commonly, interest rates are heavily subsidized (being below on-going market rates) and often also set at levels below the prevailing inflation rate which makes the effective interest rate negative in real terms. At negative interest rates, the demand for credit would be (theoretically) unlimited and the purchasing power (real value) of the loan portfolio will be eroded. When interest rates are subsidized, credit tends to leak into the hands of well-to-do persons outside the target group of the project concerned; people also tend to look at credit as a kind of a grant and loan recovery rate would be adversely affected. Under such conditions, credit programmes would not be able to continue without substantial government subsidies or external transfusion of funds. Long-term sustainability would therefore require that interest rates are high enough to cover the cost of credit operations as well as to protect the real value of the credit funds.

There is no strong case for subsidized credit: it only compromises the business-like approach of a credit programme. It is reasonable to assume that the poor will also be willing to pay interest rates at market levels; for, they value being treated with dignity and as equals rather than as 'special cases'. The Grameen Bank in Bangladesh charges market interest rates. The BKK in Indonesia in fact charges rates (3-4 per cent per month) that are higher than the market rates (but substantially lower than those charged by money-lenders) which (coupled with high loan recovery) has enabled it to generate substantial internal resources to augment the loanable fund. Experiences reveal that what the poor value most is easy access to credit and low transaction costs of borrowing (simple procedures and quick disbursement) rather than credit at cheap rates.

Charging interest rates high enough to cover costs and to maintain the real value of funds is often the most overlooked aspect of credit programmes designed for the rural poor. There is a widespread feeling that the poor cannot afford market rates, hence they must pay subsidized rates. This factor, coupled with high inflation rates, has made real interest rates negative. The erosion of the capital base that necessarily follows from such a situation will require periodical replenishment from external sources, hence the need for continued resource commitments on the part of donors.

3.6 Targeting of credit towards the poor

While there is no strong case for subsidized credit to the poor, the question arises as to whether there is a case for special credit programmes for the poor, that is programmes targeted toward specified categories of rural poor. The important issue here is that if credit is not subsidized, if every one irrespective of whether rich or poor pays the same interest rate, whether there is any rationale for targeting. The answer is necessarily a 'yes' given that market forces (operating through formal financial institutions) cannot by themselves be expected to meet the credit needs of the poor. As stated in chapter 2, formal finance finds the provision of credit for the poor both too risky and costly; the poor have been marginalized in their operations. For one thing, as stated in section 3.1, promotional activities and mobilization are essential to generate a demand for credit among the poor, and these are social investments which lie outside the market mechanism. For another, when dealing with the poor, innovative methods are needed to reduce the transaction costs of both borrowing and lending, and to lend without collateral and ensure loan recoveries. Use of such methods involve special (often labour-intensive) efforts on the part of lenders which may not always be attractive from a profitability point of view. Market forces will find it relatively more profitable to lend to the non-poor; hence, the poor will continue to get marginalized.

The rationale for targeting is illustrated by practically all case studies presented in Part II. Given the intensive efforts involved in mobilization of the poor for productive use of credit and loan repayment, the Grameen Bank has to depend on assistance from donors to cover its full operational costs. The fact that the PCRW in Nepal (funded by grants) has taken the responsibility for the 'social investment', has enabled the banks to lend to the poor and achieve high loan recovery. The BKK in Indonesia had to adopt innovative methods (such as use of character references for collateral, lending operations at market places and compulsory savings from loans) to be able to reach and serve its clients from the micro-enterprise sector. The important lessons emerging from such experiences are that if credit programmes are to reach the poor, (i) there is a need for a social investment which the market will not bear and (ii) there is a need for innovative methods to reach the poor, reduce transaction costs, and ensure loan recovery which may not be relatively attractive (and too cumbersome) for the markets to adopt. The two factors together provide a strong case for targeted programmes using public funds or donor grants.

The above two factors are also important in explaining the poor record of many rural or agricultural banks in reaching the poor and serving their credit needs. Most of these banks had no component of 'social investment' aimed at enhancing the capacities of the rural poor to demand, utilize and return credit, and had also failed to adopt innovative methods to serve the credit needs of the poor. Lacking an effective operational methodology, they have not been able to ensure high recoveries in their lending to the poor. In fact, many of these banks have shown better performance in mobilizing rural savings than in lending to the rural poor.

3.7 Evaluation of the performance of credit schemes

Finally, it is important to examine the issue of the evaluation of the performance and impact of rural credit programmes. Quite commonly, evaluation studies attempt to measure the effects that loans have on output, income and labour utilization of the borrowing households. These studies typically use the 'before-after' comparison method (comparison of borrowers' activities before and after they received the loans) or 'borrower-non borrowers' comparison (comparison of a sample of borrowers with a control group of non borrowers). There are, however, a number of factors that make the results of such studies highly questionable.

Most impact studies assume 100 per cent **additionality** meaning: (i) that a borrower allocates all of a given loan to a specified activity as agreed with the lending agency; and (ii) that the activity concerned would not have increased without the loan. The problem with this assumption is that a loan represents a generalized claim on goods and services rather than a distinct input, and given the **fungibility** of funds, that is the fact that funds could be put to many different alternative uses, it is difficult to establish that a particular amount of money was clearly spent on one distinct bundle of goods rather than on another. In practice, diversions and substitutions do occur with loans, that is to say that at least some part of a loan tend to be used for other purposes and that the activity concerned would have expanded at least to some extent without the loan concerned. The extent of such diversion and substitution can be known only if one were to collect detailed information on income and expenditure flows of households' overtime which is an almost impractical exercise. It is also difficult to separate the effects on output and incomes of credit from other inputs such as technology, and improved seeds. In the light of the above factors there is reason to believe that conventional impact studies tend to overestimate the benefits of credit programmes on income, output and employment.

Another important fact is that most evaluation studies fail to analyze the cost of administering the credit programmes, and the extent to which the programmes concerned could be self-sustaining, in the sense of capacity build-up to operate without continued dependence on outside funds. There is a growing body of opinion which take up the position that instead of trying to measure the impact of credit use at the household or farm level - something that is very difficult and costly to do - the attention should rather be focused on the abilities of the agencies concerned to sustain the programme over the long-term and to provide a flow of financial services to an increasing number of people. This position has been summarized by Dale W. Adams as follows: "Evaluations too often focus on the egg rather than the goose. The fitness of the goose and its ability to lay a number of eggs is the thing that is important, not getting a single egg".⁵ The evaluation criteria under this approach could be based on several important considerations such as the following:

- *coverage*: The number of people who have regular access to financial services, that is those receiving loans and regular depositors of savings. Is this number increasing?
- *reduction of transaction costs*: Are conscious efforts being made to reduce transaction costs for all parties concerned - the lender, savers and borrowers?
- *loan recovery*: Has the credit agency succeeded in achieving a high rate of loan recovery? Loan recovery is considered an excellent proxy for the perceived quality of the financial services provided by the credit agency and the value placed by borrowers on a continued relationship with that agency. Low transaction costs (achieved through user-friendly services) and prospects for repeat loans are important factors that encourage loan repayment;
- *savings mobilization*: What is the extent to which the project/credit agency has stimulated savings mobilization? This is revealed in the number of savings accounts, volume of savings mobilized and the extent of dependence on 'inside money' (savings mobilized) for loanable funds. Projects that perform poorly generally process mostly 'outside money' obtained from donors or governments;
- *self-financing*: Is the programme (except for promotional activities or mobilization component) self-financing in the sense that the direct costs of operations are being met out of interest income? Is the interest rate on loans adequate to maintain the real value of capital funds in the face of inflation?

The above criteria, focus on some critical dimensions in the long-term viability and self-sustained capacities of credit programmes. Meeting the above criteria could be taken as evidence that (i) the rural poor are using the credit supplies productively to generate new incomes as evidenced by their ability to repay the loans on time and at going market rates, (b) they are also raising their capacity for savings, hence to reduce the dependence on outside money and to become increasingly self-reliant, and (c) that the programme is financially self-sustaining and is also reaching an increasing number of households.

As discussed in section 3.1 above, credit provision for the poor often requires a mobilization process and a promotional phase. Awareness creation and building solidarity groups that follow such mobilization are important factors that contribute to productive utilization of credit and high loan recovery. More over, credit must be seen not as an isolated effort but as an integral part of a total effort directed towards poverty alleviation and empowerment of the rural poor. Hence, in evaluating a credit programme, it is important to use not only financial indicators (loan recovery, savings, transaction costs etc.) but also process indicators which show the underlying processes of change that contribute to the empowerment of the rural poor. Process indicators show the direction of change from a broader perspective of raising the socio-economic status of the rural poor. Among such indicators would be the following:

- *solidarity groups*: How far have the poor organized themselves to overcome their atomization and fragility, and to develop a measure of solidarity and mutual support to deal with their problems?
- *access to services*: How far have the poor succeeded in improving their access to relevant services through assertion, bargaining, negotiation and other methods?
- *improving terms of exchange*: How far have the poor taken steps to improve their terms of exchange through cooperative endeavours, that is to improve the prices they get for their produce and to lower their purchase prices of consumer goods and inputs?

⁵ Dale W. Adams: "The Conundrum of Successful Credit Projects in Floundering Rural Financial Markets", in *Economic Development and Cultural Change* (January 1988), p.365.

- *empowerment*: How far are the poor overcoming the specific socio-economic disabilities and disadvantages that they had suffered from, and are gaining a measure of confidence in their abilities to deal with their problems?

Process indicators such as above help capture the underlying processes that improve the socio-economic status of the poor, and the broader changes which mobilization efforts seek to promote. As already noted, successful credit programmes targeted towards the poor have usually been linked with social mobilization efforts.

4. Group Credit

Group-based credit with joint-and-several liability (group credit for short) has become increasingly popular in recent years as an innovative method of improving the access of the poor to credit from institutional sources and of reaching the target groups. Credit is given to a group of persons joined together in some sort of association, group or organization of their choice which secure, manage, use and repay such credit. The organized group acts as an intermediary between the credit granting project/institution and the ultimate user. It is a solidarity-group model which seeks to combine the power of self-help with the mutual support of peers within each group. Each group member stands guarantor for every other member and the borrowing rights are based on group rather than individual performance. A failure to meet an agreed loan repayment schedule results in all members of the group losing access to borrowing privileges. Experiences reveal many potentials of group credit such as the following:

- reduction in borrower and lender transaction costs through a process of externalization as described in section 2.3;
- improved loan recovery;
- greater generation of personal savings;
- scale economies not only in the provision of credit but also in providing other related extension services;
- generation of group activities in spheres other than credit;
- a sense of solidarity, security and self-reliance among participants.

Realization of the above potentials is however not *automatic*. In the first place, there must be a social environment conducive to group formation, and secondly, there must be animators/ facilitators to assist the poor to mobilize and organize. Even where organized groups exist, a number of other factors must be present for group credit to succeed:

- homogeneity of membership in the sense that members have come from more or less similar socio-economic backgrounds (that is those subject to more or less similar economic problems or having similar interests);
- in general, successes have been shown by smaller groups (compared with groups with large numbers) which tend to be coherent, where the rules and regulations are well understood by members and where the members regularly attend the group meetings - in short where the spirit of solidarity and mutual understanding tend to be high;
- existence of a common contributory group fund;
- a group must basically reflect the members' aspirations; the members must perceive the group as an instrument for furthering their economic and social interests and enhancing their human dignity. Credit is only one phase in this process. When groups are formed only to receive credit they often tend to disintegrate. If however a credit function is added to an existing group activity or where a group expands into activities beyond credit, there is better success.

It may be noted that many of the case studies presented in Part II, group formation has been used as an important method of reaching the target groups, and of providing and recovering credit. The Grameen Bank, which targets credit toward the poorest segment of the rural society, namely the landless households, has developed the most sophisticated group credit methods. While five like-minded members come together to form the base group, several such groups (generally five or six) in a neighbourhood come together to form a Centre. Members adhere to a strict code of discipline, meet regularly (weekly) at the Centre to discuss their problems, review progress and to conduct banking matters. As discussed in Chapter I of part II, impact of such group formation has gone beyond the credit sphere; there are spread effects into social development. On the other hand, the BKK in Indonesia, which disburses credit to individuals engaged in off-farm micro-enterprises, bases its lending on character references ('personal integrity') rather than group formation. The character reference from the local priest, teacher or official serves as the screening mechanism, and this method has worked well. Unlike the case of the Grameen Bank where the target group is the bottom poor

(illiterate and assetless, who will generally need the backstopping of a solidarity mechanism), the BKK has targeted its operations more towards the 'entrepreneurial' segment among poor (the 'micro-entrepreneur') who could be readily identified by a knowledgeable person such as the local priest or teacher. The lesson to be drawn from these experiences is that group formation as a basis for credit operations becomes important particularly when dealing with the bottom poor - that is poorest, the weakest and often the assetless segments of a population - than with the more entrepreneurial among the poor.

5. Credit for Rural Women

Rural women have been among the most neglected groups in development planning and programmes, and, paradoxically, one of the groups with the greatest unrealized potential. Direct access to production credit is considered an important catalyst for changing this situation given (a) the economic role of women in poor households and their income generating potential, and (b) the need for improving the social position of women. It is now increasingly recognized that rural women's labour and earnings are essential to family survival in most developing countries, particularly so in the case of landless households and even in agricultural households where the men's earning capacity has eroded as a result of such factors as environmental degradation and frequent droughts. Women's labour and earnings are of particular importance to female-headed families who are growing in number and are often among the poorest of the poor. Rural women are important not only in food production, but also in cottage industry and petty trade and commerce.

Field experiences show that in all major activities that rural women are engaged in, direct access to credit could serve as an important means of enhancing their economic participation. It is generally recognized that women could be depended upon to use their earnings more sharply for family welfare (food, health, shelter and education of children) as compared with men. However, women's economic role has by tradition been largely unacknowledged and undervalued and they have often been excluded from formal finance and extension services. In such a context, direct provision of credit to women is considered an important way to initiate a process of social and economic change for women, that is to facilitate a transition from a life of dependency and social disadvantage to greater self-confidence and self-reliance.

Field experiences with credit schemes have shown that, in general, rural women are good credit risks. Their loan repayment record has usually been high and invariably better than that of men in similar circumstances. They have proved to be more responsive to self-discipline in repayment, to take their loan obligations more seriously and are more afraid of defaulting compared with men. Statistical reporting on loan recoveries, however, is not gender-disaggregated to indicate women's credit worthiness. It is also generally the case that informal saving and credit practices are more commonly prevalent among women, which have provided them with useful credit experiences.

Rural women, however, are often constrained in engaging production activity by several factors. Time consuming domestic work or household chores (which is well documented in all developing regions) is one constraint. They often need to spend long hours on collection of water from distant sources, on collection of firewood and on processing and cooking food leaving, little time for income earning activity. In such situations, credit supported new economic activities by women could even increase their work burden. Hence the importance of initiatives to free women's time for production activity e.g., improvement of water supply, community woodlots, fuel-efficient stoves, time-saving technologies and awareness build-up among men to share household work burdens. Socio-cultural factors, male domination and illiteracy are further factors that operate to constrain women's demand for production credit. In some traditional societies, it is not merely the women's wish that counts, but also whether husbands and village leaders want women to have access to loans. Their disadvantaged position in society coupled with low educational level could adversely affect their initiatives and they may shy away from dealing with formal credit sources.

Overall, women's demand for production credit tends to require a longer time to develop than that of men's, and may need conscious promotion. Hence, direct access to credit may also have to be phased out to stimulate interest and develop confidence in credit use. The first stage may simply involve the formation of savings groups and pooling of resources for provision of small loans which gives the members confidence in their ability to use and payback credit.

Group-based lending, with joint-and-several-liability appears to encourage undertaking of financial risk by women, which they might not be able to assume as soon on their own. Many of the more successful credit programmes now use this approach. The way a group is formed, its subsequent development and specific functions vary from one programme to another. The advantages of group

solidarity transcends that of credit supply, providing material support and assistance at times of crisis, as well as enabling the women to overcome the constraints imposed by the isolation that women everywhere tend to suffer - also cooperation in other relevant activities and furthering of skills in collective decision making and leadership.

Much of the field experience to-date indicate that women often prefer to form their own groups for obtaining access to credit, separate and distinct from those of men. The situation in this regard would obviously differ from one social context to another. The decision to form separate or mixed groups would depend upon women's confidence in themselves and in the men who would join the group concerned, and their perceived ability operate on equal terms with men within a mixed organization. Separate women's groups are often preferred since the women feel more comfortable among themselves; they may also acquire greater leadership skills and self-confidence in a sex segregated environment. However, it is often stressed that separate women's groups should be considered an intermediary step towards the full participation in mixed groups on an equal footing. Capacity building through separate groups should enable such eventual integration.

In addition to group formation, most credit programmes for women (e.g. those of Women's World Banking (WWB) and UNIFEM) have a training component - technical training, training in business skills and in some cases an awareness programme on women's rights and deprivations under existing customary and statutory laws. In some programmes such as Kenya Women's Finance Trust which is affiliated to WWB, all potential credit recipients must take a one-week training course as a prerequisite for taking a loan. The topics covered include managing a business, salesmanship, basic accounting, banking and credit procedures, project preparation, legal awareness and leadership skills. The major constraint in such training programmes has been the limited educational level of the participants.⁶ Hence an important issue that women's credit and development programmes have to deal with is how to devise training approaches appropriate to the needs of illiterates and semi-illiterates who form the majority of the potential clientele in many societies.

To summarize: group formation, time-releasing methods, training (in technical and business skills), and awareness creation on rights and deprivations emerge as important components in a programme to assist women for effective utilization of credit.

Experience world-wide also suggests a number of policy level changes and macro-level actions that can be helpful in improving rural women's access to financial services and in overcoming the formal obstacles faced by financial institutions in serving them.

- (i) the most important among such changes are the appropriate legal reforms to ensure equal treatment of women. Such a policy agenda would involve reform of property laws in cases where legal restrictions exist on women's inheritance and right to own property, as well as the reforms of the civil code and the commercial code, where laws limit the legal status of women as adults and their ability to enter into contracts and make financial transactions independently. While group collateral could help overcome the effects of some of the legal restrictions, legal reform is a necessary long-term objective in opening up formal sources of credit for women. Legal reforms by themselves may not guarantee their enforcement especially so for poor rural women lacking the wherewithal to take action against institutions that violate them. However, legal reforms are a first step towards change (to create an enabling environment) and may even provide a point around which women's groups could organize and apply pressure on the institutions concerned with enforcement;
- (ii) elimination of the male-orientation and male-domination in extension services constitutes another important item in an agenda of policy reform to facilitate credit usage by women. Here there are two problems namely (a) that extension and delivery services are typically oriented towards men and (b) extension cadres are often dominated by men;
- (iii) finally, sensitization of key public officials (at national and project levels), bank officials, and NGO personnel to women's development issues through such methods as awareness raising workshops, could serve to facilitate actions to improve the access of women to credit.

6. Summary and Conclusions

Provision of credit is increasingly being looked upon as an important instrument in assisting the rural poor to improve their economic conditions - in fact as a central element in poverty alleviation strategies. However, there are many examples of credit schemes which have failed to live up to their expectations and in fact run into difficulties having failed to achieve a measure of viability and self-

⁶ See Chapter 7 of Part II on the experience of Kenya Women's Finance Trust

sustained operations in the long-term. There are not many examples which may be described as 'success stories' in the sense of continued ability to service the financial needs of an increasing number of poor households and which have developed a viable partnership with poor, so that the poor themselves attach a high value to that relationship.

This situation is largely a result of some faulty assumptions (or pre-conceived notions) which were specifically used in the designing of credit schemes. The more important of these assumptions were:

- (i) that the poor, almost by definition, have little or no saving capacity, hence, they cannot be expected to mobilize resources of their own. Therefore, their credit needs must be supplied entirely from outside sources;
- (ii) that the poor cannot afford to pay the market interest rates on their borrowing; hence, they need to be assisted by subsidies, that is to say that credit to the poor must be provided on subsidized terms rather than market terms;
- (iii) that credit is the 'missing link' in the efforts to raise the incomes of the poor; hence, the supply of credit could be expected to catalyse other resources leading to a rise in the incomes of the poor. A rise in the incomes of the poor could in turn be expected to lead to a repayment of the loans which would make the credit scheme a self-sustaining one.

Field experiences from developing countries have, in general, contradicted the above assumptions.

- there are many examples which demonstrate that the rural poor are capable of (and could be depended upon) to save regularly. In particular, the poor have demonstrated their willingness to build up substantial funds when they are organized into groups and stimulated to mobilize their own resources as a first step towards their development. The generation of such 'internal resources' helps build a sense of commitment by the poor to the credit programme of which they are members and to create prospects for a reduced dependence on 'outside money' over time. An important conclusion is that savings mobilization should be a vital component of a credit scheme for rural poor;
- success cases have also demonstrated that the rural poor are willing to pay market rates (or even higher rates) for their loans as well as to repay the loans on time, provided they derive clear benefits from the financial services provided to them, hence attach a high value to the relationship with the project concerned. Low transaction costs, quick loan disbursement and continued access to loans (to obtain a line of credit rather than a single loan) are among the benefits that the rural poor tend to value most. Hence, a credit scheme for the poor will need focus sharply on innovative methods of providing such benefits to the poor. In a project with innovative features, there is no difficulty in charging interest rates on loans to cover not only operational costs but also to protect the real value of loanable funds in the face of inflations;
- loan recovery could, however, be adversely affected by unforeseen circumstances (such as harvest failures) and factors arising out of the fragility of the economic base of the poor. Successful projects such as the Grameen Bank have attempted to deal with this problem by the setting up of contributory group funds, the resources of which are being used to repay loans in such eventualities as well as to provide consumption loans to the members thereby obviating the need to divert loans for non-productive purposes. Group funds play the role of a social insurance to ensure loan repayment and a buffer to absorb the 'shocks' of external events, hence to provide some resilience in the face of crises that adversely affect poor households.

An important general conclusion is therefore that the credit operations with the poor will need to adopt both *innovative as well as business approaches* in order to be self-sustaining in their operations - innovative approaches to reduce transaction costs and to achieve a high rate loan recovery, and business approaches to charge interest rates to cover operational costs as well as to protect the real value of loanable funds in the face of inflations.

Besides, the adoption of business and innovative approaches, a key factor in the success of credit programmes targeted toward the poor appears to be social mobilization and promotional activities - that is social intermediation to mobilize, organize and orient the people not only to use credit but also to obtain access to other complementary services, achieve improved terms of exchange and overcome other disabilities. If so, credit must be seen not as an isolated intervention but as an element of an overall strategy to alleviate poverty and empower the poor.

The important lessons that emerge from practice may be summarized as follows:

- (i) long-term sustainability of a credit programme will require that there be an organic link between savings and credit and that interest rates not less than the prevailing market rates be charged on loans;
- (ii) even minimalist credit projects (that is those confined to credit provision only without a social mobilization component) will need to use *innovative methods* to minimize transaction costs and loan defaults in order to be self-sustaining;
- (iii) minimalist credit projects which use innovative methods have proved capable of reaching some segments of the poor, particularly the more enterprising and 'progressive' elements (micro-entrepreneurs), but there is little evidence that such projects succeed in reaching the bottom poor, who are often assetless, illiterate, and the most deprived, and who generally lack confidence in their abilities for self-advancement.
- (iv) social mobilization is often a prerequisite to reach the bottom poor with credit and complementary services. As already stated, this is a process of social intermediation using trained grass roots workers to assist the poor to raise their awareness of problems and opportunities, organize themselves, and take initiatives to improve their conditions. Within such a framework, credit becomes an aspect of a broad-based integrated development process rather than an isolated effort.

The costs of such social intermediation, however, will need to be treated as promotional expenses or social investments which are generally not expected to be self-financing. Hence such costs will need to be kept separately from those of credit operations which are expected to be viable and self-financing in the long-term. While it is important to treat credit as an aspect of an overall social development and empowerment effort, it is equally important to separate the two aspects (credit and social mobilization) for accounting purposes. To mix the two functions within one and the same project without separate accounting always carries the risk that dependency on outside funds to carry out social intermediation or mobilization (which can rarely be self-financing) extends also to credit activities.

II. SELECTED CASE STUDIES AND EXPERIENCES OF PARTICIPATING AGENCIES

1. The Grameen Bank of Bangladesh

1.1 The mode of operation of the Grameen Bank

The Grameen Bank (GB) has attracted world-wide attention given its ability to reach the poorest (most of whom assetless rural women) with savings-credit services, to achieve near-cent loan recovery rates and to enhance the socio-economic status of its clientele. This note summarizes the essential steps in the operation of the GB.

1.1.1 The GB operates through a network of village level branches each of which operated by a manager with the assistance of about three bank workers (generally two of whom women). Such a branch would cover about 15 to 22 villages. The branches come under the supervision of an Area Manager who in turn works under the guidance of a Zonal Manager. The Zonal offices interacts with the Head Office but enjoys a considerable measure of autonomy in their operations.

1.1.2 The target group of the bank consists of households with less than 0.2 ha. of land. To obtain credit, persons from such households will have to form into groups of five like-minded persons (of more or less similar economic and social status). Usually only one person from a household can become a member of such a group. Hence, members of one family or even close relatives cannot be members of the same group. Men and women form separate groups. Each such group elects a chairperson and a secretary who conduct the weekly meetings of the group. Once groups have been formed, a bank worker checks the eligibility of the group members by visiting the households to obtain data on assets, income and so on.

1.1.3 A number of such groups (generally five or six) in a locality form a Centre and a chief is elected from among the chairpersons of the member groups. He/she is responsible for helping the members to learn and observe the discipline of the bank and conducts the weekly meetings of the Centre.

1.1.4 All group members will attend an intensive one week orientation course of two hours each day. The bank workers explain the rules and regulations of the bank and the rights and duties of the members. On satisfactory completion of this orientation, a person is given official recognition as a member. Prior to being eligible for loans, all members must demonstrate their sincerity and solidarity by attending all group meetings over the next three weeks. During this period, the bank workers continue discussion of GB rules and answers any questions to make sure that every member understands the benefits and responsibilities. During this period the illiterate members are also trained to put their signatures.

1.1.5 At each weekly meeting, a member will contribute one Taka to the Group Fund. At first only two members of the group will be eligible for loans. Another two members can apply for loans if the first two borrowers have been making their repayments on time for two months. The last member (often the Chairperson of the group) has to wait another two months or so until his predecessors have passed the reliability test.

1.1.6 Each loan has to be repaid in weekly instalments within a year. If one member of a group defaults, the other members will not be eligible to obtain another loan from the bank. Hence, peer pressure operates as an important factor to ensure repayment by each member. In addition, the loans must found to be remunerative if the borrowers are to take repeat loans. Weekly repayment, group pressure and profitable use of funds supplement each other in ensuring loan repayments.

1.1.7 In addition to the weekly contribution of one Taka, each member when taking a loan has to contribute 5 per cent of the loan amount into the Group Fund. The members can borrow from this Fund for any purpose, including repayment of the bank loan itself or for consumption. Members are thus helped to make repayments even in adverse circumstances and to avoid using the original loan for consumption purposes. Loans from the group fund has again to be repaid in weekly instalments. Another fund called the Emergency Fund is created by the group members with a contribution of 4 per cent of loan amount. This fund can be used only to repay a loan in the case of an emergency created by unforeseen events like a death, a theft or other natural calamity. Hence, it acts as an insurance component.

1.1.8 The group members do not have to travel to the bank office to transact business. They receive the banking services through the bank workers who visit the weekly meetings of the groups. They disburse loans, collect repayments and make all the required entries in the pass books at the Centre. There are female bank workers to deal with the female borrowers.

1.1.9 The interest rate of the GB loans is 16 per cent per annum which corresponds to the rate charged by commercial banks on agricultural loans. However, the effective rate of interest to the borrower stands at 25 per cent because of the 9 per cent of the loan amounts contributed to the group fund and the emergency fund. At this interest rate, the GB could not have covered its costs (particularly given its high staffing intensity) if not for a continued flow of low-interest funds from international donors.

1.2 **Consciousness raising efforts of the Grameen Bank⁷**

The Grameen Bank, though a specialized bank par excellence, strongly emphasizes social and human dimensions of the development process among the poor. It has gone beyond a simple 'savings-credit programme'. Evaluation reports reveal that the GB has enhanced solidarity among its members, raised their level of consciousness, encouraged them to organize mini-schools for their children, hold sports events for their children, eliminate the practice of dowry, protect themselves from common diseases (e.g. night blindness of children and diarrhoea) and finally protest against social injustices. Many of these commitments are contained in what is popularly known as the 'Sixteen Decisions', (a code of conduct) which many GB members could recite in perfect order. Among these decisions are:

- we shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest;
- we shall build and use pit-latrines;
- we shall drink tubewell water. If it is not available, we shall boil water;
- we shall not take any dowry in our sons' wedding, neither shall we give any dowry in our daughters' wedding. We shall keep the Centre free from the curse of the dowry. We shall stay away from the practice of child marriage;
- we shall not inflict any injustice on anyone, neither shall we allow anyone to do so.

The formation of solidarity groups is central to the efforts at consciousness raising and social action. The 'groups' and the 'centre' have become 'foci' for decision making and social mobilization. These collectives are increasingly asserting their importance in the life of the GB members. Thus, if one member is in trouble, financially or otherwise, other members of the group come forward to help him/her. In social occasions such as births, marriage and deaths, the 'groups' and 'centres' play an important role. For example, when a member's house was damaged by fire, the fellow members repaired the house in less than twenty-four hours. The poor women have been the greatest beneficiaries of such solidarity, being the most vulnerable group oppressed not only by their male counterparts but the society at large. Once organically linked, the poor women begin to assert their rights, in the process raising their social status. There are many experiences where solidarity groups have functioned as a countervailing power-vis-a-vis dominant elites to assert legitimate rights.

GB organizes workshops for group members at different levels culminating in national level workshops. These workshops have served as powerful instruments of awareness build up, of dispelling superstitions and acquiring scientific ideas. Use of sanitary latrines, preparation of oral rehydration salt, adoption of family planning, raising the age of marriage for daughters and rejection of dowry are among the conspicuous changes that have followed.

1.3 **What is behind Grameen Bank's success? The founder identifies the key factors in the success story⁸**

1.3.1 *Close relationship:* The close relationship that has developed between the bank and the borrower, and among the borrowers is a very important factor in the success of the Grameen Bank (GB).

1.3.2 *Peer pressure and peer support:* Formation of small five-member groups of members' own choosing, and federating the groups into centres, help create the right kind of peer pressure at times when a member tries wilfully to violate the GB rules, and peer support at times when a member falls into any difficulty in pursuing his/her economic pursuit.

1.3.3 *Reaching the poorest:* Mixing up the poor and the non-poor is a sure path to failure. The GB has made entry into a group quite an elaborate process. It has put so many check-points on

⁷ Anisur Rahman: *The Role of Tradition in Social Mobilization: The Grameen Bank and Rural Poor Women in Bangladesh* (Dhaka, BIDS, 1987)

⁸ Muhammad Yunus: *Grameen Bank: As I See It* (ILO, Geneva, November 1986), unpublished paper.

the way that it would be difficult for a non-poor to get in. Again within the eligible poor, the GB tries to reach the people at the bottom. One strategy which the GB finds helpful in reaching the poorest is to start with only women's groups. In a Muslim society like Bangladesh, it is almost difficult to attract women into groups. In such a context, it is only the desperate women who finally push their way through to form the first group. Such groups gradually set the level of economic conditions of the future members. The fact that all the GB's work is done at the door step of the members, helps the GB to know the members' economic conditions quite clearly. It is very difficult to conceal one's economic status from the GB.

1.3.4 Process of group formation: The group formation process itself contributes to the strength of the GB. Usually it takes quite a bit of time for the members to identify each other and consult each other before announcing that they wish to form a group. Many times members screen each other out before they arrive at the final five. Some drop out because of the fear instilled in them by relatives and neighbours. Before even negotiation with the bank begins, the members have already gone through a process of understanding and mutual confidence-building. By the time the bank confers on a group the much sought after 'recognition', a members has known the bank quite well, rules and procedures of the bank come quite easily to her, she has come to know her other partners in the group as well as the centre and the bank has come to know her well too. "It is a long period of suspense and learning. It gives her a lot of thrill when she receives the final 'recognition'. It is a great moment for her. She knows that she has earned it by herself. It gives her the first important lift in building self-confidence. Now she feels that she can do it."

1.3.5 GB takes time and is in no hurry: Whenever the GB decides to function in a new location, it does not rush; it rather allows the process (of understanding it by the potential clients) to take its time. The GB offers the explanation: "Why hurry? If poor people have survived without GB for all these years now, they will survive without the GB for many more years to come". A GB branch gets into operation in a slow manner. The manager of the proposed new branch and his associate will arrive in the village concerned ("they have no office, no place to stay and no one to get in touch with") and their first assignment is to understand and document everything (history, culture, economy and the poverty situation) about the area, The manager is free to decide whether he should go ahead and start the process of setting up the branch or abort the process. If he decides to continue, then he talks to people explaining the objectives and operations of the GB, organizes public meetings to explain these issues and walks for miles every day to talk to people and answer their questions. Tensions develop when the bank workers start talking to women and to mobilize them. Sometimes there is resistance from rural powerful and religious leaders. However, despite such resistance, the desperate poor women are often determined to form groups. When one group gets a loan, other women would be attracted to form into groups and the process gets accelerated.

1.3.6 Training prepares the bank staff well: GB training for bank managers is simple but rigorous. It is simple because the bulk of it is self-teaching. We find that villages of Bangladesh teach young people more things about life than books. Bank managers are young university graduates who are recruited through advertisements in national newspapers. After a two-day briefing at the training institute in Dhaka, trainees are attached to different bank branches for six months where they are asked to discover their own GB by watching others run a GB branch. "You observe everything very carefully at the branch you are attached to. When your training is over, your task would be to create a GB branch which would be better in every respect than the one in which you spent your first six months". "They are free to criticize, modify or improvise GB work procedures and bring them to their colleagues to convince them that if the proposals are accepted and introduced, GB would function better." A batch of trainees meet every two months for a period of one week to compare, share and critically analyze their findings. During these six months, the trainees for the first time come face to face with reality of rural Bangladesh; he also can see the changes and feel them. "What he sees excites him. It is not a promise for some change in the distant future. It is here, it is right now. This attracts him. He wants to be an instrument of change himself. He can see the respect he can command from people. He can see the self-respect that will generate in him for doing this. He wants to become part of GB. He wants to do it better." "GB offers the young men and women in Bangladesh a job that is perfectly in tune with their sense of social responsibility. The job is almost like the adventurous things you always wanted to do, but never had an opportunity to do it. It allows you a large amount of responsibility with a lot of flexibility." The GB has over the years developed an army of dedicated bank staff who spend most of their time in the field.

1.3.7 Decentralized organizational structure and participatory management style: The GB is a highly decentralized organization. Its organizational structure may be best described as circles within circles, where each circle is a complete one but it is located within a bigger circle. The smallest circle is the group and the biggest is the head office. The groups have federated to form the bigger

circle of the centre, a cluster of centres belongs to the bigger circle of the bank branch. Similarly, branches relate to the Area office, the Area offices to the Zonal office and the Zonal offices to the Head Office. Each bigger circle tries to pass on the responsibilities to the smaller circles within itself while keeping watch on what goes on in each constituent smaller circle. In case of emergency, higher circle takes up the responsibility more directly to bail out the lower circle. In this way, GB is a multi-layered federation of constituent units and spirit of federalism is widely visible in management decisions. It works on the principle of shared authority. Each federating unit is trying to protect its autonomy by doing things right without being told what to do. Branches try to do their things without intervention from the Area and Area tries to things without being pushed by the Zone and so on. In order to retain such autonomy, each unit has to work hard; any lapses or shortcomings will invite attention from the bigger circle.

The Head Office always tries to avoid taking unilateral decisions. If it has to frame new policies, rules and regulations, it will make drafts and circulate them among the different circles for responses. Different circles may hold internal meetings to arrive at a consensus on the issues concerned. A consultative process is set in motion before important decisions are taken. Regular conferences are held at head office, zonal and area levels to review work and discuss future plans. For example, Zonal Managers' (ZM) conference, held thrice a year, is a two or three-day intensive session which reviews the performance of each zone. "At the conclusion of each ZM's conference, I was always amazed to find how much has been achieved in such a short time. Every participant in the conference goes back to his work with new vigour and life. Many have nick-named it as the 'battery recharging conference'."

Finally, it may be noted that GB has a very strong monitoring and evaluation unit, with up-to-date management information, which can immediately identify problem cases through its computer network and thus give signal to take corrective measures.

2. The BKK Programme in Central Java (Indonesia). An Experience in Institutional Adaptation of Banks to the Rural Environment and Viability of Individual Lending to the Poor⁹

Badan Kredit Kecamatan (BKK) - meaning Sub-District Credit Institution - is a programme of rural finance that started operations in 1972 in Central Java, which is one of the larger provinces of Indonesia with a population of about 30 million. BKK consists of some 500 autonomous units operating at the sub-district level which are supervised and refinanced by the Provincial Development Bank of Central Java. It operated as a project until 1981 when it was turned into a profit-making and taxable corporation owned by the provincial government. It has received technical assistance from USAID.

BKK seeks to provide 'easy, fast and adequate*' small short-term loans, at commercial interest rates, predominantly to small enterprises engaged in off-farm income generating activities. A BKK unit (at sub-district level) has a minimum staff of two, a book-keeper and a cashier who are recruited locally and are paid low fixed salaries but augmented by an incentive bonus based on the financial performance of the unit. As a result of this link between bank staff income and profits, there is a strong incentive for the bank workers to expand the client base and maintain high collection rates.

Most lending is done through nearly 3000 village posts, usually on market days - thus 'taking the bank to the people' and keeping the borrowers' transaction costs at a minimum. In 1987, these village posts had covered about two-thirds of the 8500 villages in Central Java and the programme had reached over 400,000 clients.

No collateral is required from borrowers; but borrowers are selected on their 'personal integrity' based on character references from recognized persons such as local officials. Nor are feasibility studies carried out of the projects or purposes to be funded. The one-page loan application forms are processed in less than a week.

Initial loans are small amounts and the credit ceiling is gradually raised on the basis of past performance. In 1987 the BKK had a loan ceiling of Rp.200,000 (US\$122). BKK follows a 'graduation policy' of encouraging clients to eventually 'graduate' from the BKK and directly borrow amounts exceeding the ceiling of Rp.200,000 from the Provincial Development Bank. Borrowers could

⁹ Hans Dieter Seibel: "Finance with the Poor, by the Poor, for the Poor: Financial Technologies for the Informal Sector with Case Studies from Indonesia" in *Social Strategies* (December 1989) and T.S. Biggs et.al.: "On Minimalist Credit Programs" in *Savings and Development*, No. 1 (1991).

choose from six different types of loans with payback periods varying from 22 days to six months and a varying repayment schedules - daily, every five days, weekly, monthly, every 35 days or seasonally. In addition to the interest payment, there is a compulsory saving component amounting to between 6.5 and 20 per cent of the loan depending on the type of loan taken. BKK, however, does not offer deposit facilities for voluntary savings.

The interest rates have been set to cover all expenses, a risk premium and the cost of funds, including the expansion of the programme. The interest rates on four main loan types vary from 3.4 to 4.0 per cent per month which are higher than those charged by formal banking institutions but substantially lower than those charged by informal lenders.

The BKK programme has experienced substantial growth since its inception. During 1972-86, a total of 4.83 million small loans have been given totalling Rp. 138.4 billion (cumulative value). By 1986, it was giving more than half a million loans per year.

The loan repayment rates stand at around 98 per cent. Given their high repayment performance, borrowers have enjoyed recourse to a steady supply of loans. A sample study of 662 BKK clients, for example, revealed that borrowers had received an average of 13 consecutive loans. Most popular in rural areas was the 12-week loan type with its weekly repayment schedule on market days and in urban areas it was the 175-day loan with its 35-day repayment schedule was the most popular.

The high loan recovery rate coupled with the relatively high interest rates it charges on loans (relative to operating costs) has enabled the BKK to make a long string of profits over the years and these accumulated profits have now become the main source of funding for its lending activities. In 1987, for example, it made a profit of about US\$ 1.4 million, amounting to about 14 per cent return on the loan portfolio. The balance sheet of the BKK shows that the programme is profit-making, self-reliant and essentially self-financing its own expansion. The BKK programme has been described by evaluators as one of the few publicly funded and administered credit programmes in the world that makes money by providing loans to micro enterprises. Its attraction lies in the fact that it has successfully blended the speed and convenience of traditional moneylenders with the operating philosophy and profit margin of a commercial bank. The main strengths of BKK include:

- simple, easy and fast transaction procedures; minimum transaction costs to borrowers by offering direct services in villages on market days;
- character reference for loan eligibility instead of collateral requirements and feasibility studies;
- short maturities and high frequency of repayment;
- risk reduction by making small initial loans and by gradually raising credit ceilings on the basis of repayment performance; assured repeat credit supplies based on past repayment performance;
- commercial interest rates covering all expenses, a risk premium and cost of funds, including the expansion of the programme;
- low-cost staff recruited locally; incentive scheme for bank staff, by linking staff income to BKK profits;
- high loan recovery rate and high profitability to generate funds internally for self-reliant growth.

An important element that had not figured in the BKK programme (up to 1987) was the mobilization of voluntary savings from the customers. While it had retained a small portion of the loan as compulsory savings, it had not provided facilities for people to deposit their voluntary savings. The programme had rather depended on the interest rate as the main mechanism of internal resource mobilization. It is interesting to note that BKK programme has recently been modified to include a voluntary savings programme.

3. Production Credit for Rural Women (PCRW)

3.1 Background

Nepal qualifies as being one of the least developed countries. From a population of over 18 million only 9 per cent live in urban areas and 65 per cent of the population are below the poverty line. Additionally, it is estimated that although the overwhelming majority of the population work in the agricultural sector, 40 per cent of it remains unmonetized and there is a high incidence of landlessness and near landlessness. In this context, development aid is of crucial importance to Nepal's socio-economic situation, aid accounts for 60 per cent of Nepal's development budget and 6 per cent of

GDP. Consequently, Nepal is one of the most important 'testing grounds' for strategies of rural development and poverty alleviation.

3.2 Project features

The PCRW project began in 5 districts in 1982, and now covers 49 of Nepal's 75 districts. The project is funded by various donors including IFAD, USAID, UNICEF and CIDA. The target group is the poorest section of rural women, particularly the landless, female-headed households and members of socially disadvantaged strata or castes. The project has three main components: credit, training and community development. Broadly speaking, the objectives of the project are to raise incomes, involve the community in the development process, integrate women into the mainstream credit system, and to create a sustainable structure which will continue to pursue these objectives.

The project as such has no financial resources to loan directly, but under Nepal's Intensive Banking Programme (IBP) it is a legal requisite that a specific amount of funds are to be loaned to priority sectors of which the PCRW is one. Thus, the project attempts to link up poor rural women with the existing commercial and national banking institutions, together with the various government line agencies which provide technical support and infrastructure.

Under the IBP, families who earn less than Rs.2410 per capita/annum are eligible for credit, which is a relatively high cut-off point considering that 40 per cent of the families earn less than Rs.4 per day (Rs.1400 per annum).

At the national level policy is coordinated by the Central Advisory Board made up of representatives of various national banks and government agencies, and meets under the auspices of the Ministry of Women and Development. Regional functioning of the project is coordinated by the District Development Committees, and the day to day tasks are worked out by regular meetings between the local Women Development Assistants (WDAs), Local Development Officers (LDOs) and representatives of the local banks and government line agencies.

The Women Development Officer (WDO) is at the frontline of the project and is the intermediary between the local banks, line agencies, and the rural women. The WDO is responsible for disseminating information and organizing the women into groups. When a group member requests a loan the WDO accompanies the woman to the local bank and assures the bank of the 'security of group collateral'. The WDO is then responsible for linking the women to the technical backstopping provided by the line agencies, as well as the supervision of loan repayments. The WDO also attempts to identify appropriate income-generating activities and assess their feasibility.

The groups consist of between 4-6 members usually of the same caste, with an elected group leader. The groups meet regularly on a monthly basis with the WDO. At first loans are small in size in order to minimize risk. The average loan is Rs.2015 and most loans are for 18 months to 3 years with a six month grace period. Interest rates which are subsidized vary according to the duration, size and purpose of the loan. The overwhelming majority of the loans are used for livestock (80 per cent), followed by agriculture and services, respectively.

The various studies on the PCRW cite widely varying instalment repayment rates, ranging from 78 per cent to 93 per cent. One even notes that the figures cited could be unreliable due to the inexperience of the WDOs in book-keeping. A comparative study of credit extension projects in Nepal noted that the PCRW had one of the highest repayment rates as a direct result of the close supervision and extension work of the project staff.

Regarding savings, the information is equally contradictory. One report criticizes the project for only encouraging savings through the compulsory deduction of 5 per cent from loans. Whereas another study notes approvingly the introduction of savings boxes by the WDOs who then regularly deposit the money on behalf of the women in a local bank account. The study estimates that 65 per cent of the women are engaged in saving and that the extension workers are cited as the primary motivating force for doing so. However, the level of savings is not known.

3.3 Impact

The project has expanded greatly since its launch in 1982; it has assisted over 2,300 groups in obtaining loans to the value of over Rs.30 million, and has had over 8000 direct beneficiaries. There is little or no data available on the impact on incomes and living standards of the beneficiaries, and one study even questions the utility of the recovery rate as an indicator as it is not known whether repayment has been made through profits or by merely shifting the debt elsewhere. As we have seen,

much of the data is also contradictory. This is probably a result of the scale of the project and the involvement of several different donors in their respective project regions.

A recommendation of one study is that loans for cottage industry activities be discouraged as these are the least profitable overall. Service activities seem to be the most profitable, followed by livestock. Livestock, however is also problematic as a result of poor animal health and very poor provision of veterinary support. A compulsory livestock insurance scheme has been introduced, but this cannot be a solution to the inadequate provision of back-up services which is clearly placing a constraint on the ability of the participants to utilize the credit effectively. One response to this has been the training of para-veterinarians, another more original response was the request by one woman for a loan from the project to set up an animal service centre to meet such needs.

In all of the studies the women perceive themselves to have benefitted greatly from the project. The spillover benefits include: the provision of previously unavailable consumption goods; savings for household emergencies and festivals; improvements in literacy and numeracy; education of children; and loss of fear in dealing with the mainstream financial and government institutions.

On the negative side, however, the information suggests that the target group is not being reached adequately as a result of the overemphasis on income as a criteria, as well as the ability of those who least need the credit to gain access to it through better information and influence.

3.4 Lessons¹⁰

The PCRW is a project which acts as an intermediary between the national and commercial banks, the government line agencies, and the target group of poor rural women. As such it is not directly involved in handling funds, but seeks to bridge the gap between the mainstream financial institutions and rural women. Beyond this, the project seeks to assist the women in utilizing the credit effectively by linking them to technical services, providing training and advice, and by promoting community development projects to improve the infrastructure and working environment. The lessons and problem-areas of the project lie in these features of the project.

Firstly, the separation of the project from the handling of the funds has several implications:

- the separation allows, to some extent, the cost-effectiveness of the credit to be assessed independently of the other components of the project, although there is obviously some overlap, as much of the administration and loan supervision is presently carried out by the project staff;¹¹
- it encourages the integration of the rural poor into the mainstream channels of credit. Instead of providing a self-contained, isolated source of credit, the project has the capacity for replication and expansion on a much larger scale. The ultimate objective of the project is to promote the self-reliance of the rural poor by demonstrating to the banks that the poor are bankable, and by assisting the poor themselves to overcome the barriers and frustrations of dealing with the mainstream government and financial institutions;
- the separation allows greater scope for the participation of the beneficiaries themselves in terms of the administration and responsibility for group formation and loan supervision.

Secondly, and conversely to what has been said above, the interest rates remain subsidized and thereby limit the incentives to the banking institutions to expand their activities. Furthermore, it encourages groups other than the intended recipients to exert their influence in order to gain access to credit on such favourable terms. It also possibly acts as a disincentive to repayment as the beneficiaries are more likely to view the loans as a type of one-off grant.

Thirdly, and probably the most important problem-area is the difficulty experienced by the project to assist women to use the credit effectively by linking them up to the technical services provided by the government line agencies. There seems to be a recurring problem in credit-extension projects, namely that credit is only one input in promoting employment and improving incomes. The provision of other technical and backup services such as marketing, technological support, training and infrastructure does not seem to be possible on the same scale as that of credit provision, within the existing framework of such projects. In the PCRW case, the technical backup, particularly veterinary

¹⁰ ILO: *Savings Potential and Credit Needs of Rural Women in Nepal: A Review of Savings and Credit Programmes* (October 1991), unpublished, and Mariam S. Pal: *Production Credit for Rural Women* (IFAD), unpublished.

¹¹ Although the cost-effectiveness in the case of the PCRW has not been assessed in this manner.

services, as well as the training and community development services have not been adequate to provide the necessary support.¹²

4. Sudan Revolving Fund

4.1 Background

A joint ILO/UNHCR programming exercise in the early 1980s proposed a total of 16 income-generating projects aimed at promoting self-reliance among the refugee communities in Eastern and Central Sudan. The revolving fund was one of seven projects from this study that were implemented. The project was launched in July 1985 and has since completed its second phase. The proposal for a third 3-year phase is presently being considered. The project was initially funded by the Federal Republic of Germany, but following the results of phase I the capital available has been boosted by contributions from the EEC and ICARA II (for a women's component).

The environment in which the project has been operating has been one of severe economic deterioration and political instability. At the time of launching the project, debt service obligations in Sudan represented 5.6 times total export earnings, huge shortfalls in raw materials and other inputs were and continue to be experienced leading to massive under-utilization of capacity. Real wages between 1970-89 fell by 70 per cent, and inflation has been accelerating.

For small-scale enterprises extremely high fuel and transport costs, severe shortages of raw materials and spare parts, and also low purchasing-power of local markets have presented huge obstacles to becoming commercially viable.

4.2 Project features

There are an estimated one million refugees in Eastern and Central Sudan presenting huge pressure on services in urban areas as migration continues to take place. Consequently a large proportion of the capital available was allocated to refugee settlements in rural areas.

Although the *target group* were refugees who 'demonstrate the best capacity to realize and develop a project (enterprise)', Sudanese nationals were not excluded.¹³ Credit was extended on the basis of *group guarantee* and no collateral was required.

The six extension officers form the critical link between the refugees and the project. They initially undertake promotional activities to disseminate information on the project and encourage the formation of relatively homogenous, 'voluntary' groups. The groups consist of between 5-20 members and elect a group leader to represent them. Subsequently the extension officers are responsible for undertaking feasibility studies on applicants' businesses and credit proposals, they assist in the drawing up of applications, and clarify and defend those applications during the committee meetings of the fund. If successful the officers then take on the role of mobile bankers: dispersing the credit, taking part in the procurement and delivery of equipment and raw materials, and monitoring the progress of the businesses. Finally, they must regularly collect loan instalment repayments.

The *interest rate*, or 'administrative charge' under Shari'a law, was initially 3 per cent p.a., but was increased to 10 per cent for most of the project duration, and since January 1990 it has been 15 per cent. The phase III proposal advocates a stepped increase in rates to 40 per cent by 1994.

The overwhelming majority of loans were made to groups. Individual loans were made but also on the basis of group guarantee. The average *loan size* was 12,000 Sudanese pounds for an average *duration* of 45 months.¹⁴ Hence by the end of phase II only 27 per cent of loans were due for full repayment. Overall most of the borrowers have *utilized* the credit for animal husbandry (38 per cent), followed by small-scale industry (28 per cent) and services (23 per cent).

¹² Needless to say the quality of the information generated by the project is also a problem. This is probably due, in addition to the factors already mentioned, to the overburdening of the field staff through cumbersome loan application forms and surveys of the target group.

¹³ Overall Sudanese nationals represented 27% of the beneficiaries.

¹⁴ The maximum loan duration has since been reduced to 3 years.

At the end of Phase I the instalment *repayment rate* was 96 per cent and overall the rate has been 89.9 per cent. Most defaults are thought to have been due to difficulties in access (eg. rains) or as a result of severe difficulties in obtaining raw materials.¹⁵

4.3 Impact

In most of its targets in terms of the number of loans, beneficiaries, jobs created and rates of (instalment) repayment the project has been an unequivocal success. By the end of phase II the project had funded a total of 412 enterprises, with a total loan value of 5.12 million Sudanese pounds. The overall repayment rate, as mentioned, was just under 90 per cent, the project directly benefitted 1,708 people (24 per cent of whom were women) and created 2,459 jobs.

The project documents, however, admit that extension officers have been unable to collate data on the impact of the credit in terms of income, production techniques, etc. Of the information that does exist the signs are that the project has been a success in this respect as well. A survey of the first 103 projects found a rate of return on the capital employed of 212 per cent, and that the average monthly income of the beneficiaries had reached US\$73. Subsequent evaluations, with smaller sample sizes, have also noted the positive impact of the credit:

- "The asset base of the beneficiaries has widened and their income has risen substantially;"
- "...in a majority of cases the loan facility has enabled them (the beneficiaries) to lift their operations to a new level of production;"
- "The project has generated a general awareness of their (the beneficiaries) development prospects and has rekindled savings and banking habits among the refugees."

In contrast to these factors, however, the project has been able to approve only 412 loans out of a total of 25,000 applications, which itself is only a small fraction of the needs of the refugee communities. The project has no savings component to draw on capital resources within the community in order to promote self-reliance and inculcate the savings 'habit'.

The stipulated objective of creating a 'self-financing', 'wholly Sudanese' entity by the end of phase II proved to be over-ambitious. This is not surprising given the high overhead costs and an (official) inflation rate over the period of at least 70 per cent per annum. It is estimated, based on 1990 figures and even excluding overhead costs, that if the real value of the average loan were to be maintained, then the number of loans would fall from 109 (in 1990) to just 19 in ten years. The overhead costs themselves represent 63.2 per cent of the total budget of the project.

On the 18th May 1990 the Refugee Development Foundation was registered as a non-profit making company, marking an important step in the process of institutionalizing the project. The management committee of the foundation is made up of representatives from the Commissioner for Refugees, the Sudanese Islamic and Workers' Bank, Sudan Aid, and the Revolving Fund's Borrower's Association. The phase III proposal largely concerns the transfer of responsibilities from the project team to the foundation. Central to this is the development and strengthening of the Borrowers' Association to the extent that it may adequately represent its members' interests in the working of the fund. In this manner there is clearly scope for the borrowers themselves to take on greater administrative and participatory roles in the functioning of the fund, and may also prove to be a means of keeping down the overhead costs.

It is clear, however, that the project and its successor company will require continuous capital replenishment (and even expansion) as the possibilities of becoming self-financing are remote. Under other such revolving funds this is normal procedure and the assessment of the project should clearly not be restricted to 'financial viability'.

4.4 Lessons¹⁶

The preliminary preparations at the beginning of the project investigated the possibility of disbursing credit through existing institutional channels. However, no suitable counterpart was identified, which is not surprising given the conditions in Sudan and the nature of the target group - refugees. Thus, the alternative was to set up a self-contained revolving fund with the initial lump sum

¹⁵ The project included a technology and marketing component but this has been described as a "drop in the ocean" in relation to the demand on the part of the borrowers. in short, too small to be effective.

¹⁶ *Evaluation Report* (June 1990), unpublished, and *Phase I Terminal Report*, unpublished, and J. Madeley: *The Income-generating Activities for Refugees created by the Revolving Fund in Sudan* (January 1990), unpublished, and Colin Relf: *Institutionalizing the Revolving Fund*, unpublished.

of capital provided by the Federal Republic of Germany. The main problems that have been faced by the project fall into two broad categories, namely: the problems that face any revolving fund in comparison to extending credit by other means such as a credit guarantee fund; and secondly, the particularly grave socio-economic and political conditions in which the project was operating.

As we have seen, the project appears to have been extremely costly in relation to the amount of credit disbursed. The proportion of overhead costs to the total sum disbursed is 63.2 per cent. Additionally, the project, by the end of phase II, had financed only 412 projects (out of a total of 25,000 applications) to the value of 5.12 million Sudanese pounds. Having stressed that there was no alternative at the time to establishing a revolving fund, it should still be noted that a credit guarantee fund (CGFs) would have opened up the possibility of extending credit on a far larger scale given the same initial capital available.¹⁷ Another important factor regarding CGFs is that, in theory at least, the cost of administering the credit falls on the financial counterpart (the bank) which is recovered from the interest levied and possibly from income generated from any savings that maybe deposited with the bank. It is important to note that the Sudan revolving fund project provided a variety of inputs in addition to credit, including training, technological and marketing support, as well as monitoring the project itself. However, there is no individual breakdown of the costs of these components. Thus, the cost of actually administering the credit itself cannot be directly assessed.

One factor which links the two broad problem areas discussed is the rate of inflation. The annual rate of inflation is conservatively estimated to have been between 80-120 per cent. Under these conditions, not only is it very difficult to charge viable commercial rates of interest given the objectives of the project, but also the capital base is continuously and rapidly diminished in real terms - in short, the fund does not revolve. For the beneficiaries, such highly concessional terms give the impression that the loan is some sort of a grant, and without continuous large-scale capital replenishment then there is little chance of the borrowers receiving repeat loans. Thus, not only are important incentives for repayment removed, but the credit is likely to be only a temporary support, where as credit is rarely a one-off requirement.

The transition of the project to a non-profit making company under phase III spells a new era for the revolving fund. The attempt to integrate the borrowers themselves into the structure of the institution through the borrowers association opens up the possibilities of far greater participation and responsibility, as well as providing an important avenue for cutting costs. The possibility is there for the borrowers themselves to take-over important roles such as the supervision of loan repayments and stimulating and monitoring group formation.

Another factor which is an important aspect of the third phase of the project is the introduction of a savings component. The fact that there has not been any stimulation of savings amongst the refugee community is an important criticism of the project. Initially there was an assumption that the refugees would have no capacity to save, and therefore a savings component would simply be superfluous. Following this, difficulties experienced in institutionalizing the project took precedence over most other considerations. However, the organic link between credit and savings needs to be stressed. Other than adding to the capital available, savings form a critical aspect in improving the economic situation of the target group. Added to this is that savings increase the likelihood that a high proportion of the loans are repaid. Apart from providing the facilities to encourage general voluntary savings, the introduction of compulsory savings schemes or emergency funds provides a backstop for the beneficiaries to meet repayments at times of particular hardship.

Having made these criticisms and drawn various lessons from them, it is important to note that they do not constitute an indictment of the project, rather, they highlight the severe conditions under which the project had to operate and the extent to which these conditions constrained the options available. Given the socio-economic context it is very hard to evaluate the performance of the project in terms of its impact on the beneficiaries. It is indeed a significant achievement that the income-generating activities of the beneficiaries raised sufficient income to enable to meet their repayments and maintain the very respectable recovery rate that has been achieved.

¹⁷ It would also, assuming defaults were not excessive, maintain its real value by accruing interest on the capital sum deposited with the bank.

5. **Strengthening of Manpower and Employment Programmes: Bangladesh**¹⁸

As part of a broader objective of strengthening the Bangladeshi government's employment promotion programme, the ILO/UNDP project assisted in the implementation of a cash loan scheme.

5.1 **Project features**

In the first phase of the project (September 1982 - December 1986) a US\$25,000 guarantee fund was placed with the Sonali Bank as security for the bank to commence the distribution of loans to the rural poor. The project in its first phase operated in 200 villages that were not covered by other such credit schemes (e.g. the Grameen Bank).

The Sonali bank, through its local branches, began distributing loans in November 1984 and by the end of 1985, roughly 9,800 beneficiaries had received loans (4,000 of which were women). The rate of interest charged was 13 per cent (simple interest) plus a 3 per cent administrative charge. Additionally, penalties were imposed on delinquency. By this time, however, the Sonali Bank announced that it had liquidity problems and no further loans were disbursed. In October 1988, after some delay the project recommenced. A new agreement was reached, this time with the Agrani Bank, and a guarantee fund of \$90,000 financed by UNDP was deposited with the bank. The bank was to disburse loans and cover its costs through the interest and administration charge levied, although the project also shared some of the administrative burden.

Household surveys were carried out to identify the target group of potential beneficiaries, namely the landless, female-headed households and unemployed youths. A feature of the project is the field workers are original residents of the village, selected among the beneficiaries themselves and paid on a commission basis as a percentage of loans repaid (2 per cent). The field worker organizes the selected beneficiaries into small loan groups of approximately 5 members, who meet regularly before and after receiving the loans which are made on the basis of group collateral. The field worker, in co-ordination with the manpower survey officer, also assists the beneficiaries in submitting their loan application and supervising repayments.

In the initial group meetings as well as during training sessions, the beneficiaries were encouraged to develop regular savings habits. They were encouraged to open bank accounts with a minimum of Tk. 10 per person as a pre-requisite of being eligible for a loan. Subsequently, they were required to save at the rate of Tk. 10 per instalment repaid. In this manner, over Tk. 2.5 million has been deposited with the Agrani Bank. This has proved to be a major incentive for the bank in entering loan activities under the project.

In the second phase, as well as reactivating the project in the 200 villages of phase I, an additional 135 villages were selected. Phase II is due for completion in June 1992. By the end of 1990, the project had succeeded in disbursing Tk. 75 million to over 21,000 beneficiaries.

5.2 **Impact**

The project has greatly increased its scale and succeeded in providing credit to a great number of beneficiaries but it has fallen well short of its, possibly over-optimistic, target of 40,000 loans.

There are also a number of other important criticisms of the project:

- most important being that the default rate has been quite high. Officially, the figure is 23 per cent but it is acknowledged that this does not include repayment of the interest on the loans. The banks estimate that the figure is probably closer to 40 per cent. It is thought that the high default rate is due to inadequate supervision, possibly because of low incentives for the field workers who are paid on a commission basis. It has been noted that group collateral without adequate supervision probably acts as a disincentive to repayment; when a member defaults without incurring any penalties other members see little incentive in making repayments. Additionally, the drying up of loans from the Sonali scheme removed the incentive of repayment in order to secure repeat loans;
- the project is said to have operated in isolation;
- there has been confusion as to whether beneficiaries should be limited to heads of households, thereby restricting female participation;

¹⁸ Prepared by Adam Norris. See ILO: *Self-Employment Programmes in Bangladesh: Experiences of Selected Organizations* (Dhaka, 1991) and ILO: *Evaluation Report* (EMP/TEC, April 1991), *Project Findings and Recommendations* (1987) and *The Sonali Banking Plan, Technical Report No.2* (March 1990)

- to some extent the target group has been by-passed as the banks sought to give credit to, what they considered, the more bankable clients.

5.3 **Lessons**

The same country-specific factors that enable the Grameen Bank to achieve such startling results must also apply in this project. Factors such as Bangladesh's high rural population density and generous supply of educated manpower both serve to keep the unit costs of loan supervision lower than it would be elsewhere. However, this project has been unable to even approach the successes of the Grameen Bank. One report even noted that the cash loan scheme had tried to emulate factors from the Grameen Bank without understanding them properly. In particular, the process of group formation and the relationship between 'group collateral' and loan supervision. It appears that the project has placed a greater premium on maintaining the pace of disbursement at the expense of insuring adequate supervision of borrowers' income-generating activities and loan repayments. The significant gaps of time between the two phases and other delays in the disbursement of credit also served to remove the important stimulus to repayment of seeking further loans.

One important area in which the project has had some success is that of savings. In this area as well, the project has been criticized for not adequately formalizing the procedure. However, the level of savings achieved illustrates well the willingness and the ability of the poor to save. Furthermore, it is one critical area where the interest of banks and borrowers fully coincide. On the one hand, the level of savings has been sufficient enough to prove to be an important incentive for the bank to continue and even expand its operations. On the other hand, the savings provide an important backstop for the poor and are an important step towards self-reliance, as ultimately it is through savings that the extension of credit should be financed.

6. **UNIFEM's Experiences with Financial Services for Women: A Note¹⁹**

UN Development Fund for Women (UNIFEM) has funded 22 credit projects or credit components of umbrella projects in 16 countries for a cumulative total of over US\$ 5.6 million as of July 1990. UNIFEM has organized three strategies to channel financial and technical resources to women within a credit programme. They are (i) Revolving Loan Funds (RLFs), (ii) Credit Support Systems (CRESS) and (iii) Interlinkages between Mainstreaming and Credit.

Revolving loan funds (RLF): UNIFEM has pioneered the provision of revolving fund loans to poor women with no collateral to meet their credit and equity needs - for equipment and for start-up capital for variety of activities relating mainly to food production. These loans are in the form of finances for capital investment of groups, as community revolving loan funds to serve the financial needs of the local community and as collateral for attracting larger loans from local banks. Banks have granted poor women loans many times higher than the original amount of seed money provided by UNIFEM.

Credit support systems (CRESS): This is an attempt to provide training and extension support to strengthen the credit mechanism. CRESS provides the following support services to the credit projects:

- technical assistance at all stages of the project cycle as well as technical appraisal of pipeline credit projects;
- negotiations, on behalf of the local women's organizations, with banks and financial institutions, to design cooperation frameworks to make formal credit accessible to women and to use their technical expertise;
- research and investigations such as baseline studies and analysis of pre-project situations to improve design of credit projects and to help in monitoring and evaluation;
- training and exchange visits for both project management and beneficiaries.

Interlinkages between mainstreaming and credit: UNIFEM not only provides credit directly to women's groups or through financial intermediaries, but it also brings women into the mainstream financial markets by influencing banking and financial institutions to direct credit to poor women. Both roles reinforce each other. On the one hand, by giving credit to women's experimental projects, UNIFEM demonstrates to planners and policy makers how this approach works and the creditworthiness of the women borrowers. On the other hand, when UNIFEM assists women to `be

¹⁹ IFAD et al.: *Interregional Training Seminar Report on How to Improve Banking for Rural Women* (Nicosia, Cyprus, 19-30 November, 1990)

on the agenda' of financial institutions, it helps to shape the policies and programmes of these institutions and to allocate more financial resources to women. In addition, UNIFEM is giving increasing attention to: the role of women in private sector development, negotiations with banks and financial institutions, use of informal credit and savings and the possible linkages between informal and formal financial institutions, and studies on the effects of inflation and structural adjustment on women's purchasing power.

Some examples of UNIFEM projects are: Swaziland Self Help Scheme through the provision of Revolving Loan Fund, Tanzania Credit Scheme for Productive Activities, and agreements with the Lesotho Agricultural Development Bank for 'Mapotu Village Community Development and Improved Technologies for Women' and the Liberia Agricultural and Cooperative Bank.

The main lessons from UNIFEM experiences are as follows:

- rural women have potential for savings, and all credit projects should include a component for savings;
- group formation as a central component;
- competent and motivated field staff;
- the importance of training as a means of ensuring repayment, particularly accounting, finance and management training for low income women.

7. Women's World Banking (WWB): Experience in Facilitating Banking for Women: A Note

Women's World Banking (WWB) is an internationally initiated non-profit organization which addresses the needs of women in micro business, especially regarding credit, markets and business skills. Its basic objectives are to bring women into the mainstream of the economy; to assist women in having access to credit through formal sources; to provide them with training in business skills and to network among affiliates, institutions and the women themselves. WWB has about 50 independent affiliates in 44 countries and over the last ten years, it has mobilized over US\$ 10 million to guarantee loans.

A national/local affiliate is a registered legal entity which may be a company, a cooperative society, or a non-profit organization. One major responsibility of local affiliates is to help bankers work with women. Some have set up savings schemes; some provide training and consulting services. The affiliate guaranteeing the loan arranges tripartite agreements through which the bank lends to the women approved by the affiliate. Borrowers pay a fee of 3 per cent of the loan for the guarantee facility - 1 per cent to the affiliate and 2 per cent to WWB - which is deposited in the local WWB account to cater to the loss of a default if any. If women default, the WWB reimburses the bank 50 per cent and the local affiliate reimburses 25 per cent. Therefore the bank risks only 25 per cent. The African experience shows that this scheme has increased banks' willingness to lend to women with a recovery rate of 97 per cent and a global default rate of less than 1.5 per cent

Training includes: basic accounting and marketing, quality control, stock control and other business skills; legal training and information regarding licences required, payment of taxes, avoidance of illicit arrangements, existing laws which provide equal rights for men and women, and those statutory/customary laws which deprive women of their individual civil rights.

WWB encourages and assists affiliates to set up revolving loan funds through which women entrepreneurs may apply for small amounts. This includes training in credit management to qualify for larger loans. The interest rate charged could be the market one or slightly lower, depending on the terms and conditions of funds obtained for establishing the revolving fund.

In Kenya, for example, the WWB affiliate is the Kenya Women's Finance Trust (KWFT) which is registered as a non-profit organization. It has two basic programmes namely training for women and credit for women. The credit programme is of two types: the Revolving Loan Fund and the Loan Guarantee Scheme. The revolving fund provides 'mini-loans' to women entrepreneurs whose credit needs are too small for bank financing. It provides both individual and group loans. KWFT engages in close monitoring and supervision of borrowers and reports a repayment rate of 90 per cent. On the other hand, the loan guarantee scheme is used to guarantee loans by larger and more viable borrowers from commercial banks. All potential credit recipients must take the training course as a prerequisite to receiving a loan. (However, training is also given to women who will not be receiving a loan) A one-week course is provided to all applicants, with a small fee charged to cover the costs of tea and supplies. The training is conducted in small groups, whenever possible for women of similar educational background and from the same area and the topics covered include managing a business,

salesmanship, basic accounting, banking and credit, planning, legal awareness and leadership skills. The major constraint has been the limited education level of the participants. KWFT is developing a training approach directly attuned to the needs of the illiterates and semi-literates who form the majority of the potential clientele in rural areas. It would be a combination of lectures, drama, role playing and discussions.

8. Learning from Money Lenders²⁰

The shortcomings of traditional micro-enterprise credit projects can be traced primarily to their reliance on credit methodologies copied from formal sector banking. For example, the lengthy and complicated loan application procedures, demanding guarantee requirements and slow service turn formal lenders into inappropriate credit sources for micro businesses. Unlike banks, informal moneylenders develop a *modus operandi* with each client, based on a personal relationship that relies on constant interaction, a tacit establishment of mutual trust and an offer of quick access to financing. This method of operation provides important advantages for the micro businesses. If micro business programs are to reach their stated goals, they will have to learn from these moneylenders, and beat them at their game. The key lessons that can be learned from informal lenders and transferred to credit programs for small entrepreneurs may be divided into four primary areas:

- Credit risk;
- total borrower cost for credit obtained;
- borrower selection; and
- collection mechanisms

Credit risk: The first lesson from moneylenders is that micro businesses are good credit risks due to their inherent profitability. Attempts to understand the nature of this profitability demonstrates some important yet often ignored characteristics of micro businesses. A recent study conducted among 320 of the smallest businesses in 40 poor neighbourhoods in Costa Rica revealed a gross return on assets of 700 per cent annually for businesses with an average of US\$833 in total assets. A similar study of small commerce in Bolivia revealed gross rates of returns of over 100 per cent a year for businesses with an average of US\$545 in assets. Rates of return for the very smallest reached much higher levels. Smaller the business, the faster it rotated its assets. In fact, the smallest businesses rotated their assets 48 times a year, while the largest ones rotated only four times annually. Many of the street peddlers rotate their entire inventory every day or two, and earn profit margins from 50 to 100 per cent per day. In spite of these findings, formal lenders are not willing to invest in this sector. The transaction costs to process a loan application are too high and micro businesses are perceived as high risk clients. Country level studies show that in general, only about 10 per cent of micro businesses have access to formal sector credit.

Total cost of credit to the borrower: The second important lesson to be learnt is that informal lenders reduce their financial transaction and accessibility costs to a minimum by using lending practices which reflect the needs and realities of micro-enterprise clients. When compared to formal lending, the interest charged on informal credit is high. Moneylenders are the micro entrepreneurs of financial markets who invest their personal capital directly into their loan portfolios. The financial return to a moneylender must therefore be similar to the returns on productive capital for micro businesses which, as noted earlier, are quite high. Although their interest charges are high, the informal lenders impose little or no costs on borrowers that they cannot collect as direct financial charges. In that sense, their credit delivery systems are designed for maximum efficiency and lowest borrower cost. They offer a fast and responsive service which substantially reduces the transaction costs to the borrowers. At most, the borrower must complete a simple guarantee document before receiving the loan. There is no application process other than a casual conversation and the loan disbursement often takes place on the same day. (It may be noted that on any small loan which requires three or four office visits, the transaction costs often tend to be high and even exceed the direct financial costs).

No credit is more expensive than delayed credit. When micro businesses turn their limited capital over 20 to 30 times a year, delayed credit can be very costly. When lenders cannot deliver credit in a timely manner, borrowers could forego opportunities to purchase inputs or equipment under favourable conditions, lose important contracts or other investment opportunities. Such accessibility costs resulting from delays in loan disbursements are minimized under informal lending.

²⁰ Robert Peck Christen: *What micro-enterprise Credit Programs can learn from the Moneylenders* (Discussion Paper Series, Document No. 4, Acción Internacional, October 1989)

Borrower selection: The third key lesson gathered from an analysis of moneylenders' practices is that they know their clients well, develop a relationship with them and know their clients' general businesses environment. Informal lenders are often involved in other commercial aspects of micro businesses such as selling raw materials and purchasing final products. These activities give them ample opportunity to understand micro businesses over time and in different situations, and not to perceive them only as a credit customer. Since informal lenders usually know both the potential client and his/her business rather closely, it is relatively easy for them to establish a borrower's willingness to repay a loan as well as his/her repayment capacity. Unlike the formal lenders, informal lenders may not particularly be interested in the potential borrower's specific investment plans; they may rather want to know only whether the borrower is generally financially sound. On the other hand, formal lenders lack such first-hand knowledge about their potential clients; hence, they would often require a guarantor or a co-signer. However, in the informal sector, such a potential co-signer is likely to be another micro entrepreneur, who may not probably be reliable in the eyes of the bank. To emulate moneylenders, micro enterprise credit programs must seek non-traditional means of identifying trustworthy clients. Two such mechanisms would be (i) lending to solidarity groups under a group guarantee system and (b) 'stepped' or incremental lending, where a start is made with small and relatively short-term loans and the loan amount and the loan period are gradually increased if the payback is on time. A knowledge of the client develops overtime.

Collection mechanisms: This is the final area in which micro-enterprise credit programs can learn from informal lenders. The lessons in this area are simple, but crucial. Borrowers repay informal lenders because they know that should they default they will be sanctioned. Such sanctions may include repossession of assets, community ostracism, legal prosecution or even the threat of physical abuse. This certainty of sanctions is the backdrop on which informal lenders operate. This is the simplest, yet toughest, lesson for micro-credit programs to learn. These are cases where a calamity strikes a borrower and impedes repayment. These, however, can be identified easily and the credit program and the borrower can reach an agreement to renegotiate the loan based on circumstance and need. However, the overwhelming frequency of loan delinquency in most programs is the direct result of institutional laxity or borrower irresponsibility. Hence, it would be crucial for the success of a micro-enterprise program that sanctions be defined and strictly enforced.

9. Credit Programmes for Small Farmers: Some Lessons from the Experiences of USAID²¹

Between 1950 and 1985, AID funding for credit programs primarily aimed at promoting farmer investment in improved agricultural technology totalled slightly over US\$1 billion. On the whole, most credit programs encountered serious implementation problems and failed to meet their stated objectives. For example, an evaluation study found that, of 45 agricultural credit programs implemented between 1973 and 1985, only 11 (less than 25 per cent) of these projects facilitated farmers' adoption of the recommended technologies. AID's experience provides useful insights and identifies important issues that should be considered in designing credit programs.

Most agricultural credit programs were implemented in the following manner:

- a direct transfer of AID funds was made to a central bank or agricultural development bank for a designated credit program;
- the funds were subsequently made available to other intermediary financial institutions (e.g. rural branches of banks, co-operatives or credit unions) at a discount rate;
- finally, the intermediary institutions lent the funds to the targeted farm population at an interest rate specified by the government (usually at below market rates). The loans were usually short-term and could only be used for a particular purpose (e.g. purchase of recommended inputs).

The ideal conditions for a successful credit program based on the above model would have been the following:

- the farmers used the loans to purchase the necessary inputs to invest in a new technology supported by the program;
- the increased production that resulted enabled the farmers to increase their farm income, improve their standard of living and repay loans;

²¹ Siew Tuan Chew: *Credit Programs for Small Farmers: A Project Manager's Reference* (Washington, US Agency for International Development, June 1987).

- the loan repayments (received by the lending institutions) were turned over as new loans, and the credit program proved self-sustaining. The initial capital provided under the program constituted a revolving fund that generated sufficient revenue for participating institutions to cover their lending costs and to continue lending.

The evaluations, however, revealed that the experience of the majority of the programs rarely matched the above conditions. In fact, many programs encountered serious implementation problems and financial problems, and had not facilitated the adoption of the recommended technologies. The important lessons learned are summarized below:

Feasible conditions for promoting agricultural investments: The basic assumption of many agricultural credit programs is that the availability of credit would encourage small farmers to invest in new or improved technology. AID's experience indicates that this assumption is likely to hold only when certain conditions exist or can be met.

- market demand and government pricing policies are favourable to increased production of project-supported crops;
- the project-supported technology is profitable and appropriate for the target population;
- input and other supplies, extension services, and marketing facilities to support the new technology are adequate and can be delivered on a timely basis;
- the target population has the land and labour resources to invest in the new technology.

Because these conditions did not exist or were difficult to meet in developing countries, only a minority of AID-sponsored credit programs successfully stimulated agricultural investment. In general, AID's experience indicates that decision makers should assess whether a credit program is appropriate, given existing conditions and what preconditions have to be established before a credit program could be attempted. Premature introduction of a credit program should be avoided.

Subsidized interest rate policies: A fundamental lesson from AID's experience is that if a credit program is to be financially viable and self-sustaining, *positive real interest rates* should be charged for loans. Many AID-sponsored credit programs provided loans at subsidized interest rates mandated by the host country government. The interest rates were usually significantly below market rates and often below inflation rates as well. Consequently, many credit programs were providing loans at negative real interest rates and could not generate sufficient revenue to allow financial institutions to cover all lending costs. Eventually, the combined effect of negative real interest rates and low rates of loan recovery caused many programs to decapitalize; that is, they faced a steady loss in both the amount and the real value of their lending capital, hence the credit program could not be self-sustaining. Hence, substantial government subsidies were required for governments to enable the lending institutions to continue their lending operations.

Sustainability (or financial viability) of credit programs would therefore require decontrolling of interest rates, which may require, however, policy reforms going beyond the project level.

Credit program design and administration: AID's experience identifies (besides interest rate) several other key issues that could be addressed to improve the performance of credit programs. They include the following:

- measures to reduce transaction costs;
- measures to deal with the effects of inflation;
- protection against bad debt;
- loan portfolio design to take account of the local socio-economic characteristics;
- choice of financial institutions: bank networks versus local organizations.

Evaluating the impact of credit programs: The fungibility of credit (i.e., the fact that credit can be used in many ways), the high cost of monitoring loan usage and the shortcomings of standard survey methodology should be considered in evaluating the impact of credit programs. Standard data collection approaches are costly and cannot adequately assess the direct benefits of credit programmes. One option is to abandon the idea of empirically demonstrating the impact of credit programs on farm income and agricultural production. Instead, the focus could be on monitoring and evaluating progress in developing efficient and self-sustaining rural financial institutions to serve small farmers and other rural clientele.

10. Twelve Key Principles for Guiding a Credit Policy in Favour of Development based on

Self-help²²

As conceptualized by participants of the International Workshop on Savings and Credit Village Banks held in Mali in March/April 1989 based on their individual experiences and exposures to concrete village projects in Mali.

10.1 Credit policy

The overall credit policy must be defined, implemented, controlled and adjusted by the beneficiaries themselves, in order to maintain good adaptability to the socio-cultural and economic realities of the milieu concerned. This is an important methodological choice which ensures that the approach to credit and its application takes into account the specific socio-economic context and the traditional ways of organizing.

10.2 Resources

The guiding principle should be the 'use of savings funds for credit'. If the money is always provided from the outside, self-reliant development is restrained, and an attitude of 'waiting for assistance' tends to be developed. In cases where the volume of savings is small, investigate the possibilities of getting access to external refinancing and also the means of developing a 'savings culture', in a system which links the two mechanisms. The ideal situation is where a village bank is in a position to satisfy the credit demand. When this is not possible, external solutions must be explored together with the bank, and savings must be encouraged parallelly. It has to be analyzed with the village whether all the saving capacities have been actually mobilized, for, the people must feel that it is their own efforts that make credit possible.

10.3 Beneficiaries

In order to obtain credit, a person must be a member who dwells in the 'territory' of the bank concerned and have made deposits. Some flexibility may be needed in certain cases such as a person who does not have the means to pay the initial contribution to become a member.

10.4 Objects

It is stressed that parallel to the provision of credit, other support be also provided to enable the successful utilization of the credit. This would be particularly important for economic projects (e.g. preliminary studies, project identification, ideas about income generating activities etc.)

10.5 Credit conditions

The freedom to fix the interest rates by taking into account the 'economic and financial situation of the environment' and the loan amounts and terms to be decided flexibly according to the demand and available resources. In the case of collateral or guarantee, it would be necessary to attach an important role to the moral guarantee and village solidarity, so that the poorest may accede to credit, as not every body is in a position to offer a material guarantee.

10.6 Credit granting decision

The decision to grant credit must be taken by a structure which is elected by the beneficiary villagers and controlled by them.

10.7 Criteria of credit decisions

The use of simple criteria which the decision-making body could easily apply as they know the applicants (e.g. moral reference, capacity to use credit and the will to repay)

10.8 Procedures (from demand to withdrawal of funds)

These procedures must be simple and quick so as to avoid discouraging borrowers. For the administrators and decision makers also, the system must be easy to master and to apply 'without complicated files and lengthy collection of information'.

10.9 Fixing the available credit line

The persons in charge of the village bank must work out the pedagogical and management tools which allow for easy understanding and mastery.

²² Report of the International Workshop on Self-reliant Savings and Credit Village Banks sponsored by Inter-cooperation and C.I.D.R. (Mopti, Mali, March 31-April 8, 1989)

10.10 Follow-up of the maturity date

As the borrowers may not necessarily be familiar with the repayment schedule, a reminder should be sent to the borrowers before the due dates.

10.11 Follow-up of activities

It would also be necessary to ensure that the credit has been used according to the object provided for. Where necessary, borrowers must be assisted, in particular to assess the adequacy between resources generated and the credit rates applied, and also by supporting innovative activities.

10.12 Recovery

The recovery of the credit must be settled in the milieu, by means of social pressure, without any external intervention which could jeopardize the confidence in the system.

11. Conclusions of an OXFAM Study on Credit Schemes²³

Attempts to offer very poor people the chance of a better livelihood by the introduction of new ways of saving and obtaining credit have often run into difficulties. This does not mean that the principle is wrong: many have succeeded in raising living standards and in promoting community development. For people with almost no resources of their own who are seeking to raise their level of income, some form of credit is vital.

The conclusion drawn here is that the role of small scale credit and savings schemes in the development process is crucial, and that their effectiveness can be enhanced, and their impact maximized, if the following points are borne in mind with regard to design and administration.

- (1) credit is usually extended as one element of a plan to introduce new and improved production methods, so the scheme as a whole must be viable. If it lacks important inputs, or if insufficient credit is allowed, the credit element will fail along with the rest of the scheme;
- (2) credit does not necessarily imply the provision of loan funds. Given encouragement, many communities can provide their members with funds for investment through communal saving systems, and agencies can often tap formal institutions for funds for small borrowers by acting as guarantors or intermediaries;
- (3) credit is in any case only viable in conjunction with schemes which include an adequate programme of training. Participants need to understand fully any new techniques they involve and, where appropriate, to have access to extension services;
- (4) credit itself may be a foreign concept; beneficiaries should understand their obligations clearly and be trained in book-keeping. Accounts fulfil the double function of both informing lenders and also encouraging financial discipline among borrowers, so they should be compiled and published regularly;
- (5) credit-based development schemes are more likely to achieve their objectives where their beneficiaries are not just consulted about their needs, but also participate actively in design and administration. The process helps project-holders to avoid making errors and assumptions about the social and economic background;
- (6) default is often a sign that insufficient attention has been paid to either design, or monitoring, or both. If default is not to spread, rapid remedial action is needed;
- (7) interest should be charged to mitigate the effects of inflation and to encourage a sense of independence. The equivalent of the local bank rate for personal loans would be appropriate. A project which cannot support a reasonable rate of interest (in kind if necessary) is not viable for credit finance;
- (8) small scale schemes for the very poor, if properly administered, can be the most rewarding ones in terms of the improvement to their living conditions, the building of new community structures, and repayment records.

It would perhaps be helpful to get away from the notion of a 'credit programme', and instead to see credit as simply one tool, albeit a powerful one, in integrated programmes of development.

12. Characteristics of Successful Lending Projects

A review of successful micro-lending projects both within and outside of the United Nations system shows how credit can best be delivered. In general, successful credit projects:

²³ Stephen Devereux and Henry Pares: *A Manual of Credit and Savings for the Poor of Developing Countries* (OXFAM, 1987).

- (a) **Work directly in the community**
Project staff are actively involved in community outreach, working through local organizations and fora to explain the services provided, identify loan candidates, and check references. Staff are in the villages and poor neighbourhoods almost daily, visiting borrowers and explaining requirements to potential clients. Meetings are often held in the communities.
- (b) **Simplify application procedures to a minimum**
In terms of payback, there seems to be little difference between projects that 'write a book' on each applicant and try to guess who will be successful based on formal business criteria and those that reduce applications to one or two pages. In most of the projects described below, selection is delegated to a community-based group, or else the projects have a person on the staff who knows who is reliable, or can find this out quickly. At this level, having a client chosen as a reliable borrower by peers is as effective as carrying out an elaborate feasibility study. It is more important to spend time with borrowers after they have received their loans, when their growing economic activities are stretching their management capacity, than it is to fill out extensive intake forms.
- (c) **Extend credit quickly**
Loan applicants become discouraged if they have to wait months before receiving services. They are accustomed to moneylenders who dispense money, albeit at exorbitant rates on the spot. Well-managed projects extend credit in less than a month and often within a week. Subsequently loans are approved even faster.
- (d) **Do not require books and complex business plans initially**
An interest in better planning, management and record-keeping tends to emerge as small farms and micro-business begin to grow. Keeping in mind that only a small percentage of farmers, traders and micro-manufacturers at this level keep any kind of written records, and that very simple systems, or perhaps none at all, are more appropriate, staff do not insist that tiny business reflect the organization and work style of larger firms.
- (e) **Do not require guarantees that eliminate most of the potential candidates**
Alternative mechanisms, such as 'solidarity groups' and 'circles', where three to eight tiny business owners are mutually responsible for the payback of loans, or village banks where loans funds and savings are managed at the village level, substitute effectively for conventional guarantees. The individual's reputation in the community is more important than collateral.
- (f) **Work with existing economic activities, no matter how small, or work with start-ups or other equally tiny business that are appropriate for the community**
The start-up of larger enterprises is seldom successful and requires extensive inputs for an extended period.
- (g) **Focus initially on the local market**
Local entrepreneurs and small farmers can find 'niches' where an outside expert may have thought none existed. Efforts to find new markets are often more costly and difficult than expected.
- (h) **Extend small short-term loans primarily for working capital initially**
Larger loans for fixed assets are provided later, after the owner has proven capable of repaying the smaller loans. Small, short-term loans not only 'test' the borrower's commitment to repay, but also allow the borrower to see whether or not a loan will, in fact, help the business grow.
- (i) **Charge for interest at the market rate or higher**
From the perspective of clients, quick credit is more important than a low interest rate. For very small businesses, the percentage charged on the loan is rarely a crucial factor in business profitability. On the other hand, an adequate interest rate ensures continuing bank interest in the project if administering these loans is profitable. Also, high interest loans tend to ensure

that the needy, and not those accommodated elsewhere in the formal credit system, receive the loans.

(j) **Assume the rural poor can save a significant part of their income**

The Rural Banks of Ghana have demonstrated that 90 per cent of the loan fund can be mobilized from the villagers themselves. BKK borrowers save 3.4 per cent of the face value of the loans each month. The mobilization of savings also builds local commitment to the programme.

(k) **Assume the loan recipients, with their network of friendships and their relationships within the community, will take a major role in promoting the programme**

Borrowers form their own groups and provide each other with advice and assistance, thereby reducing operational costs significantly. At the same time, this intensified interaction serves to develop a commitment to the project and to each other.

(l) **Develop large-scale, self-sufficient, profitable projects that are sustained by locally mobilized savings and are managed by local banking sector, or work in close coordination with local banks**

The involvement of the formal financial sector is vital for efforts that will reach a significant part of the rural and urban poor in the long run. Smaller-scale NGO projects, funded with grants for their revolving loan funds, may be the only option available in some countries, however.

Source: Jeffrey and Christopher Cosslet: *Credit for the Poor: Past Activities and Future Directions for the UNDP* (UNDP Policy Discussion Paper, 1989).