

DEVFINANCE

Discussion list on development finance of the Ohio State University

A monthly review

February 2000

General Information¹

➤ **Hot versus cold money?**

Is it more difficult for members of a cooperative to pay back funds from the government than to pay back member's money? Norm MacIsaac discusses the ways to ensure that cooperatives pay back the money from the government, taking the example of the Rural Self-reliance Fund of the Nepalese Central Bank (N. MacIsaac, 23rd February 2000, Re: Hot vs Cold Money).

➤ **Information for Development in the 21st Century**

The UK Department for International Development is backing an internet based system which links development research directly to policymakers and practitioners around the world. Hosted by the Institute of Development Studies (University of Sussex), the initiative is known as ID21. The address of the web-site is <http://www.id21.org>.

➤ **FAO/GTZ initiative: Agricultural Finance Revisited**

FAO and GTZ have created a webpage on agricultural finance, in regard of the shrinking volume of agricultural credit resources in many developing countries since the beginning of the 1980s. The aim of the website is to supply key decision makers in the political and institutional field in developing countries, as well as donor and executing agencies with innovative concepts for the sustainable provision of agricultural sector and small farmer oriented financial services. The address is: <http://www.fao.org/ag/ags/agsm/faogtz.htm>.

➤ **MBP Newsletter**

The Microenterprise Best Practices Project has published its last newsletter which contains interesting information on its research program, publications and events (Nhu-An Tran, 1st February 2000, MBP Newsletter, January 2000).

Courses and seminars

➤ **Microfinance and credit schemes for small, medium sized and micro enterprises**

This training programme is organised by the Social Finance Unit and the International Training Centre of the International Labour Organisation (ILO) in Turin. It aims at improving SME's access to financial services in accordance to their needs and conditions. The course takes place from 13th to 25th March 2000 in Turin, Italy. For more information, send a mail to the International Training Centre of the ILO, at SME@itcilo.it.

➤ **International microcredit conference**

A major international conference on micro-credit and enterprise in the United Kingdom is to be held in Norwich on April 4th and 5th 2000. The conference, entitled "small change for a better future" is organised by the Women's Employment, Enterprise and Training Unit (WEETU) and will pull together leading international experts and practitioners from the UK. For more information, contact Ann Nicholls at WEETU on conf@weetu.org or search the web at www.weetu.org/credit/listings.html.

➤ **Training sessions to the GIRAFE appraisal and rating indicators in Benin**

PlaNet Finance organises two sessions on the GIRAFE methodology, in Cotonou (Benin), on 15th to 17th and 21st to 23rd March 2000. For further information, contact Alice Negre, at PlaNet Finance in Paris, anegre

¹ The most relevant articles of the discussion list are mentioned in the text with their author, date of issue and subject. They are to be found in the annexe, classified in the same order as they appear in the present text.

Subjects of interest

Publications

➤ **Effects of Financial Access on Savings by Low-Income People**

This study by Aportela Fernando (1998), from MIT, analyses whether the access of Mexican low-income households to financial institutions has any impact on their savings rate. The manuscript can be ordered from the author at aportela@mit.edu. For a resume of the most relevant findings, see in the annexe, Schreiner M., 20th February 2000, Good Impact Studies I.

➤ **Impact of Group Lending in Northeast Thailand**

This study has been written by Coleman, Brett E. (1999) and published in the Journal of Development Economics, Vol. 69, pp. 105-141. The author uses a survey of participants and non participants in village banks to measure the impact of the banks on indicators like changes in household wealth, household self-employment and school expenses for girls. The result of the study does not show any significant impact of village banks. While for some groups of the population, the impact is negative, for others it is positive. It also seems that the impact of those loans that were used in microenterprise depended heavily on household unobservables (personal attitude).

➤ **Savings and Credit Association in Indonesia**

Hotze Lont (June 1999), *The Usaha Kesejahteraan Keluarga: Portrait of an Accumulating Savings and Credit Association in Urban Yogyakarta (Indonesia)*, Amsterdam School for Social Science Research. One of the main findings of the study is that these savings and credit associations played an important role in rebuilding social cohesion in the community after it was decimated by a war in the mid-1960s. For a copy of the study, contact the author at: lont@pscw.uva.nl.

➤ **Inaction on savings mobilisation**

Every once in a while, Dale Adams, an experienced microfinance practitioner and researcher, addresses the question of (lack of) savings mobilisation in microfinance institutions. In his opinion, the problem lies in the absence of willingness from donors and policy makers. Various arguments are used to justify inaction on deposit mobilisation, of which the most frequently advanced are: 1. People are too poor or too unsophisticated to save. 2. Poor people need more debt which, in turn, will solve most poverty. 3. If poor people place their money in formal deposits, these funds would flow out of depressed areas, instead of being available for local lending. 4. It is unfair to encourage poor people to place their savings in financial institutions because these deposits are then sometimes exposed to an inflation tax. 5. It is too costly to mobilise small deposits. (D.W. Adams, 26th February 2000, Inaction on savings mobilisation).

➤ **Rotating Savings and Credit Associations**

In Trinidad and Tobago, banks and credit unions are numerous and efficient. Nevertheless, it seems that informal financial self-help mechanisms, like roscas (Rotating Savings and Credit Associations) or susus (original French word), literally flourish in that country. Why can't credit unions adjust their financial products to substitute for most susus? These interesting observations on the coexistence of informal and formal finance have been addressed by Dale Adams and have generated a very intensive discussion on the list.

Maybe credit unions are not "substitutes" to roscas, because they do not fill out the same needs. Rosca members might not want to have interference with any external organisation, for reasons of trust. Or they want to participate in local activities. Thus, roscas have a **social, as well as an economic function**, their members might have to show that they actively contribute to the local society. In Taiwan, mainly owners of mid-sized businesses participate in roscas. In this case, it seems to be a vehicle to create long term relationships for de-facto vertical and horizontal integration of their firms.

According to F. Bouman, roscas and similar informal systems will remain popular because of their **versatility and adaptability** to changes in the environment, like for example inflation or emergency funds. No bank or credit union can match the same appeal, they provide no extra services and hardly any protection against inflation. They only offer bureaucracy and a great loss of time. What is very worrying, is that policymakers persistently deny the existence of self-help financial groups, although they do often participate in a group themselves!

Actually, roscas might as well represent a **savings mechanism**. Some people join several groups, with different pay out dates so that they can plan for a holiday or a special family expense. In some cases, there is a cashier who collects money from each member. People also participate in more than one group as an insurance against losing too much if the cashier runs away with the collections. Finally, one might be wanting to save in a rosca, rather than a bank, because it is more motivating to save when there is a group and a **feeling of obligation**. According to N. MacIsaac from Nepal, research by a Nepalese institute in 1996 has allowed to estimate the existence of 12'000 informal savings and credit organisation. By then, the amount of savings mobilised by those informal organisations in rural areas surpassed that of all formal institutions combined. The Community-Based Economic Development Project in Nepal supports financial self-help groups in rural communities. "The strength of this approach is that it builds on traditional practices in rural Nepal." (N. MacIsaac, 14th February).

Roscas are subject to **continuous changes and evolution**, their function lying along a continuum running from social, on the one hand, to economic, on the other. Social reasons are dominant in the early beginnings, but tend to give way to economic functions over time. In that ultimate phase, there are often no meetings and funds may even be collected and distributed without participants knowing each other. Some roscas have evolved into banks. Microentrepreneurs organise Roscas to collect seed capital and start a business, or use the group to boost sales, selling goods on credit, sometimes at a discount (F. Bouman).

Why aren't there parallel informal finance systems in the **developed economies** of the

richest OECD countries? N. MacIsaac (Nepal) exposes his explanations. Actually, it seems that in industrial countries, collective forms of informal finance, where people pool their money, seem to be less prevalent. First, there is an economic reason to that. People do not need such financial mechanisms because they have more easy access to loans, even for consumption purposes. Second, there is the cultural aspect. Social pressure is stronger in rural communities in developing countries than anywhere in industrial countries.

According to H. Lont (University of Amsterdam), there are some savings clubs in the Netherlands, like funeral societies in rural hamlets or savings clubs among regular customers of village pubs. Nevertheless, Dutch people do not massively participate in roscas because they earn more and do not have difficulties to save. Those who do have difficulties will have great problems in finding like-minded others! More reasons why Dutch people do not build financial self-help groups, are that they have good access to services of banks, insurance companies, etc., the welfare state protects them against the hazards of life, their social networks are fragmented, mixing friendship with finance is not appreciated and, last but not least, Dutch people do not have time to go to regular meetings of savings clubs. In industrialised countries, it seems that it is not really institutional modernisation that has worked against the existence of financial self-help groups, but rather **social and cultural modernisation**.

Roscas have emerged in the North through the recent inflows of immigrants from the South. In the United States, roscas are common **among immigrants** from Central America, the Caribbean, Southeast Asia, Korea and West Africa. There seem even to exist roscas among IMF and World Bank employees in the Washington D.C. offices, both professionals and cleaners. In the United States, a survey of 300 people with incomes under US\$ 25'000 a year has been made to study their financial practices. A resume of the main conclusions is to be found in the annexe, Didier Thys, 15th February 2000, Roscas in Trinidad and Tobago.

Concluding from the different contributions on the subject, roscas show that **huge numbers of people wish to save**, and lacking better choices, will create systems of

their own. Nevertheless D. Adams thinks that roscas are an awkward form of saving, because they do not provide the members as much liquidity as more formal types of deposits and they diminish the confidentiality of one's savings. A large majority of rosca members would be better served if they had access to more attractive forms of semi-formal and formal deposits. Still, other services provided by the self-help groups, "... ought to be the **bread and butter of microfinance** programs: providing contractual savings programs, making small loans, offering burial insurance, and providing emergency loans. (...) The design of microfinance programs ought to be demand driven, rather than driven by importing best practices and some institutions from afar...". (Dale Adams, 11th February).

According to people from Adalux, the real problem is that banks and central monetary authorities are not real partners in integrating semi-formal and informal successful savings groups into the financial system. "**Mobilising and managing small savings is expensive** per unit and entails a long-term commitment towards having a large branch network and a system that maintains direct contact with the clients, as well as (excellent) financial management capabilities." (ADA, 22nd February).

➤ **Informal finance in India**

Imon Ghosh from Calcutta, India, has made a study on the huge informal finance market in India, called "Reducing Rural Poverty in India" (available from the author at imon@vsnl.com or on the web at www.egroups.com/group/sharenetbox/21.html). As a conclusion to the study, the author suggests to provide **re-financing facilities to rural moneylenders**, in order to lend more to the poor. His argumentation is linked to the size of the country and the importance of the rural sector. India has over 576'000 villages and only 50'000 bank branches, most of which are located in cities and towns. MFIs may serve the rural poor better than most branch banks do, but it would be too great a challenge willing to deserve all Indian villages. The informal credit sector, on the other hand, has presence in every village and centuries long experience.

According to I. Ghosh, for a rural credit delivery system to be efficient (in promoting

economic growth and reducing rural poverty), the availability of (a) affordable credit, (b) in adequate quantities, (c) in a timely manner is a crucial factor. Informal moneylenders generally do well in criteria (b) and (c), but not in criteria (a). The modern financial sector does comparatively well in criteria (a) (interest rates are low), and very poorly in (b) and (c). Reforming India's modern financial sector is too complicated (too little geographical coverage, too much bureaucracy, too little respect for the rural poor, etc.). It would be easier to reduce the interest rate in the informal sector, through increased competition among the moneylenders. Moreover, moneylenders have better relationships in the rural markets than formal bankers do. They have the confidence of a segment that is not served by the formal financier. In isolated communities, where other forms of finance delivery mechanisms become prohibitively expensive, moneylenders may be the only option.

T. Giehler from FAO does not agree that it would be a good idea to refinance moneylenders, for the following reasons. First, he thinks that the unattractive profit margins practised by NABARD and the Reserve Bank would discourage moneylenders to use these public funds. Second, rural moneylenders in India are not interested in providing credit for investment, neither do they have the appropriate credit technology to do so. Usually, they extend short term loans for urgent and unforeseen cases. Third, if public money is involved, rent seekers might take profit out of it.

In **Sri Lanka** such a financing scheme through money lenders was implemented in 1989 by the government owned People's Bank. Moneylenders who could furnish hard collateral against refinance were enrolled as agents of the bank with license to re-lend. The agent had to show that the money was lent to at least 20 people by way of submitting the list of final borrowers to the bank. Refinancing was done at 18 percent and final lending at 30. For unknown reasons, the scheme was discontinued after two or three years.

Since it was established in 1935, the Reserve Bank of India (RBI) has been trying to bring indigenous bankers under its orbit of influence. Nevertheless the RBI has never succeeded in doing so, not because of unattractive profit margins, but rather

because of its **many conditions imposed to indigenous bankers**. The bank suggested that the indigenous bankers should abandon their trading and commission business, switch over to a western system of accounting, develop the deposit side of banking activities, have their accounts audited by certified accountants and submit to the RBI a periodical statement of their affairs. See more in the annexe, Carlos Ani, 26th February 2000, Informal finance in India.

In 1986, as an APRACA member, India has chosen to finance the poor through informal networks, like self-help groups (SHG) and solidarity groups, rather than through traditional moneylenders. This has led to the **SHG - bank linkage programme**, where usually the NGOs form the SHG. Group members then gather savings from each of them and lend them among each other. After a six months period, if the experiment has been successful, the group is linked to local formal financial institutions for financing.

According to N. Srinivasan, the linkage programme has been very successful in increasing the coverage of financial services in rural India. The last few years' record of NABARD and RBI speak for their flexibility and imaginative handling of the microfinance sector. Credit coverage of institutions in India has gone up to 64% of households compared to less than 20% in the late sixties. As of March 1999, around 40'000 informal groups have been linked to banks for financial services. Another major success of the programme, in the opinion of K. Rajamaram, is that banks now begin to feel that through SHG, poor people are more "bankable" than before. For more information on the results and effectiveness of this linkage programme, see in the annexe, Srinivasan, 24th February 2000, Informal finance in India.

➤ **Different interest rates between group lending and individual lending?**

Participants in the list have noticed that some MFIs charge different interest rates, depending on whether they handle out a group loan or an individual loan, while others charge the same rate for all types of loans. According to D. Thys from Freedom from Hunger, in almost all cooperatives and banks that charge differentiated interest rates, the group based lending products will be priced

higher than the individual lending products. It seems that group-based lending systems involve relatively higher per unit costs than individual lending systems.

For example, Mibanco in Perú charges different interest rates according to the size of the loan. Smaller loans are more expensive because relatively more costly to administrate. The Aga Khan Support Programme in Pakistan, on the contrary, charges less (15%) for group loans than for individual loans (24%, with 2% rebate for on-time repayment).

Imran Matin tries to find arguments for higher interest rates in group loans. He says that if individual loan clients are "graduate" from a group loan programme, they would be "the tested cream" (ability to repay loans) and given their higher loan size (and lower per unit cost), the interest rate in individual loans should be lower than in group loans.

Actually, interest charged on group loans should be lower than on individual loans of similar size, because the very idea of group loans is that screening and monitoring costs are delegated to the group, at least in part. Nevertheless, group loans might be more expensive because they are often targeted at more marginalised groups. Bancosol in Bolivia offers larger and cheaper individual loans, backed by collateral, to some customers, but continues to sell a group loan contract without collateral guarantee to less wealthy customers (J. Conning).

On the other hand, there are those who argue that group loans should charge higher interest rates because they imply a low average individual loan size and are more staff intensive, due to their mobile banking orientation (they go to the clients). Moreover, individual loans are for longer periods with fewer repayments - mainly agricultural in nature (D. Thys, Freedom from Hunger).

PADME in Benin started to charge the same interest rate on all loans for the three following reasons: 1. As a new institution, it wanted to be competitive and, thus, charged low rates. 2. The government restricted the institutions from charging more than 24 percent per annum on any loans. 3. It was easier for the accounting system and new staff. As PADME evolves and develops, pricing should reflect more the reality of costs. The process for an individual client requesting a \$1,000 loan is the same for each

individual group member requesting \$100. There is still the interview for 30 minutes (although in a group) as there is for individuals, and the site visit to each of the group members. It is this latter element of mandatory site visits to all clients that increases costs for groups (time and transport logistics particularly). Costs also greatly increase in the event of late payments and default, in terms of having to contact each of three to five group members to see that the obligation for one loan is satisfied (Ross Croulet).

Isabelle Dauner, Lausanne, 10th March 2000

ANNEXES

Date sent:	Wed, 23 Feb 2000 21:20:16 +0530
Send reply to:	devfinance@lists.acs.ohio-state.edu
From:	"Norm MacIsaac" <macisaac@mos.com.np>
To:	<devfinance@lists.acs.ohio-state.edu>
Subject:	Re: Hot vs Cold Money

Dear Leonard,

You are right that there are lessons for the ongoing debate regarding "hot vs cold money". I also questioned the impact on the ownership of the co-op's fund. The jury is still out, but there are some aspects to consider when thinking through the hot-cold funds analysis. (Sorry, again, when it rains, it pours).

The Rural Self-Reliance Fund of the Nepal Rastra Bank (central bank) is an increasingly important source of funding for savings and credit co-operatives. It might not seem like a lot, but in the Nepalese context, it counts (cumulatively about Rs.30,000,000 or a little less than half a million dollars).

1. Do the members find it harder to pay back government money than their own members' money?

One (short) answer is that they are not just repaying money, they are ensuring on-going access to other members and to themselves.

There are a few good lessons learned here.

1. There are incentives to repayment. First of all, they start small, and gradually increase the loan size. Often, they won't give subsequent loans until the first batch is paid, and unless payments have been regular and on time.

2. Second, loans are to the co-operative (wholesale), but they are linked to individual loan applications. This has caused some problems, especially given the time it can take to process applications. However, the big advantage is that other members depend on repayment of the first loans to get access to loans themselves. Peer pressure based on rotating instalments.

3. Third, loans are often paid in instalments, say a few at a time. Let's say a co-operative has access to Rs.300,000, this will be paid out in two or three instalments over the year. Hence, again, the last batch of loan recipients is pressuring the first batch to keep up their loan payments. Likewise, those hoping to apply to loans next round are also eyeing repayment.

4. The Fund offers a big interest rebate for on-time repayment. Loans are way below market rates (8%) and the co-operative only has to pay an effective rate of 2% if they repay on time (By the way, this rate will probably/hopefully rise in the near future).

5. Finally, access to credit is related to the overall financial health and performance of the institution. Access to credit is limited, based on the capital base of the institution (maximum Rs.500,000 or 15 times the total savings generated by the group). Loan policies within savings and credit co-operatives in Nepal also often link loan access to share holdings and savings.

Repayment of the fund has been quite good, and disbursements have been increasing steadily.

Here's the way I see hot and cold money in the context of the Rural Self-Reliance Fund, where the funds aren't just dumped into the pot. In general terms, we tend to think of hot and cold money like water in the bathtub. The more cold water, the cooler the bath. However, in this case, it is different. Rather, because of the instalments, it works more along the principle of loans extended in a solidarity group. Even if most of the money in the group lending programme is cold, people value their turn to get an instalment, and their repeated access to funds. However, maybe we could differentiate between hot and cold funds and hot and cold member loans? In the former, it's like the bathtub analogy. In the latter, when combined with instalment approach, the rules change. For instance, in a co-operative with 120 members, 24 have loans linked to the Rural Self-Reliance Fund. We might call this a 20% cold member loans ratio (or should we compare it to the number of loan recipients?), even though the loan amount might be considerably higher, even over 50%. Add to this the fact that loans are paid out in instalments (up to 8% cold member loans at one time), and the fact others are counting on the next batch of loans (maybe another 20% of the membership), and, voilà, the hot-cold equation changes

dramatically. Still, you could argue that the cold water still applies, but there are many factors involved, and, like the hot-cold analogy, there is no neat econometric equation that works in the real world.

A question I am still wondering is whether the important thing is the ratio of members to cold member loans, or the ratio of loan recipients to those who want to have access to loans in the future. Or maybe it's just the on-going access to loan funds? Any thoughts?

The co-operatives in the Philippines tend to repay the Landbank because they take them seriously (as opposed to NGO loans, which they view as "soft"). Many co-operative leaders told me they feared legal action. They also won awards for repayment (best practice?).

This raises another question: Is the on-going access the key, or the fear of legal action or seizure of assets? In Nepal, I think social pressure (in this case, combined with on-going access) is the key. If you don't repay, and because of you the whole community loses access to credit, then imagine the social consequences. This is similar to the reason why the first recipient of the "prize" in the ROSCA continues to pay her instalments.

Incidentally, I am not aware of any co-operatives that have collapsed as a result of cold money infusion.

In summary, here are some of the factors I have observed:

- a.. incentives for timely repayment, such as the interest rate rebate;
- b.. link financing to individual loans (it's not just adding money to the pot);
- c.. disbursement on an instalment basis, and in batches;
- d.. gradually increasing the amount of financing available;
- e.. amount of credit is linked to the organisation's capital base;
- f.. individual loans may also be linked to savings and share capital;
- g.. financing is available to the health of the institution; and (last but not least .)
- h.. this is a permanent programme, not a fund created which might not be around tomorrow.

So, there's a quick overview. These are the lessons learned. Maybe we will learn more later, the hard way. Hopefully not though! Any warnings from the wise? Any weaknesses?

Anyway, it changes the old hot-cold funds analogy a little, doesn't it? Or am I missing something!? [Any comments? I welcome your feedback, analysis.](#)

By the way, thanks for asking. I will include these lessons learned in my upcoming paper!

Norm MacIsaac
Community-Based Economic Development Project (CBED)
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Date sent:	Tue, 1 Feb 2000 19:11:55 -0500
Send reply to:	devfinance@lists.acs.ohio-state.edu
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Subject:	MBP Newsletter, January 2000

MICROENTERPRISE BEST PRACTICES
A NEWSLETTER OF THE MBP PROJECT
VOLUME 2, NO. 2 JANUARY 2000

MBP RESEARCH-WHAT'S NEW IN 2000

As MBP enters the new millennium, we are launching several new activities that we hope will capture the current innovations and move forward the state of the practice in the microenterprise development field. With two more years to go in the project, MBP is also developing a comprehensive toolkit to strengthen the knowledge foundation of the microenterprise development professional. For more details on completed MBP research, visit our website at <http://www.mip.org/pubs/mbp-res.htm>.

The MBP research agenda is composed of the following tracks:

* Building Markets for Business Development Services (BDS): Diagnosis and Interventions * Business Development Services Performance Measurement * Commercialization of Microfinance * Regulation and Supervision of

Microfinance * New Products and Management Tools for Microfinance * Managing Risks and Emergencies in Microfinance * Rural Finance in Africa

Building Markets for Business Development Services: Diagnosis and Interventions. MBP is undertaking three major activities under this track:

1. Market Diagnostics for Designing BDS Interventions. This paper offers an approach to examine and understand how services are bought and sold, and how donor interventions can be designed to encourage the evolution of a market for a specific business development service.
2. Voucher financing schemes. This joint MBP-IDB research will be conducted in three phases: 1) a Paraguay case study that focuses specifically on the training market dynamics and assesses the impact of the project on the privatization of the training market; 2) an action research component to identify and test key features of the voucher model; and 3) a synthesis report to update knowledge on best practices at each stage of market entry, development, and exit.
3. Strategic linkages and network brokering. The first phase of this research involves a review of relevant experience of networking for microenterprise development in developing countries, including the UNIDO cluster development program in India. The second phase involves an action research program that will result in the development of tools and training materials for network brokers, as well as a policy paper to guide donors on where and how to intervene effectively.

BDS Performance Measurement. MBP is undertaking a field test of the existing performance measurement framework (PMF) developed by Mary McVay, by applying it to existing BDS projects through a learning network of BDS practitioners funded under the MBP Grant Facility (see Grant section for more details). The field test will result in a user's manual and a series of tools for measuring the performance of BDS programs. These tools will include Market Assessment Tool; Sustainability Assessment tool; Cost-Benefit or Return On Investment (ROI) tool; Customer Satisfaction & Value-Added survey tool; and a Survey tool for assessing "Changes in Business Practices."

Commercialization of Microfinance. MBP has completed the conceptual framework for commercialization of microfinance in Latin America, as well as three case studies in Bolivia and Panama (see MBP Publications). Future research activities in this area are being explored.

Regulation and Supervision of Microfinance. MBP's future work in this area will focus on alternative forms of regulation and supervision. In collaboration with the SEEP Network, Calmeadow, and other partners, MBP plans to conduct the following activities:

1. Performance monitoring by apex organizations. This paper will review the performance monitoring methods employed by several microfinance support institutions and analyze the costs and benefits, the advantages and disadvantages, of each approach, from the perspectives of both the support institution and the affiliate.
2. Performance monitoring toolkit for national/regional microfinance associations. This toolkit will enable membership associations to collect performance data, establish performance standards, and identify opportunities for capacity building. The toolkit will include a) a manual that outlines the process; b) a summary of recommended ratios and their purpose; c) sample data collection forms; and d) basic software that will facilitate the analysis and reporting process.
3. Governance training course for microfinance institutions (MFI) boards of directors. This course will serve as an orientation to board directors on their duties and responsibilities as a director of a microfinance institution, including performance monitoring responsibilities.
4. Alternative Forms of Supervision Synthesis paper. This paper will review and assess the full spectrum of alternative regulatory and supervisory mechanisms for microfinance, from self-supervision to market-based supervision such as disclosure requirements by microfinance institutions.

New Products and Management Tools for Microfinance. The objective of this research track is to capture innovations in the area of new product development, and to equip microfinance practitioners with the appropriate tools for institutional development.

1. Management Information Systems for Microfinance. In partnership with CGAP, MBP will conduct follow-up research on the existing MIS evaluation framework to produce 1) a review and consumer report of 10 in-house and off-the-shelf systems; 2) a user's guide for evaluating information systems using the existing framework; and 3) training materials for practitioners.

2. In addition to the recently completed research on insurance for low-income households, MBP will complete its study on the provision of housing microfinance (see June 1999 newsletter) during the coming year. Other potential studies under this track include leasing, remittances, and risk management products such as savings and emergency loans.

Managing Risks and Emergencies in Microfinance. MBP is planning some exciting follow-up work to the landmark MBP publications "Microfinance in the Wake of Natural Disasters" and "Microfinance in the Wake of Conflict."

1. Natural Disaster Preparedness Manual. MBP will develop a disaster management manual for MFI practitioners to help them plan ahead for potential disasters, to implement risk-proofing measures at the institutional and client levels, and to properly respond after the disasters hit.

2. Post-Conflict Microfinance Toolkit. MBP will prepare a series of technical briefs to (a) help stakeholders to determine whether microfinance is appropriate to their situation, and to guide them on how to implement such a strategy successfully; (b) provide MFIs working in post-conflict situations with specific technical information to resolve some of the most pressing issues confronting them in the field; and (c) help non-MFIs to understand the necessary preconditions they should meet before entering the microfinance arena.

3. Microfinance in Hyperinflation Conditions. MBP is completing a comparative analysis of Opportunity International's experience in responding to the hyperinflation conditions in Bulgaria and Russia. The study is designed to serve institutions that continue to operate during high inflation by identifying the process and costs of trying to serve clients through a period of high inflation.

4. Microfinance in Critical Health Environments. MBP is completing a report on the impact of chronic illnesses, such as HIV/AIDS, on microfinance institutions. This initial report is based on findings of a rapid reconnaissance trip to Kenya, Uganda, and Zimbabwe.

5. Risk Management Synthesis Paper. Based on the results of the above research, MBP will prepare a synthesis document providing a framework for risk management by MFIs. The paper will evaluate how environmental shocks affect the risk profile of microfinance institutions and suggest ways in which these shocks can be lessened on MFIs.

Rural Finance in Africa. MBP will develop a framework for the USAID Conference on Advancing Microfinance in Rural West Africa, to be held in Bamako, Mali, from February 22-25, 2000. The study will focus on the clients, the products, and the institutions to determine the impact and interrelation of these different elements on the overall growth of financial services in rural West Africa. In addition, MBP is planning to document institutional transformation in West Africa. This study aims to capture the lessons learned from those institutions in Central and West Africa that have successfully completed the transformation process from donor project or NGO-sponsored programs to an independent MFI. The study will focus on the individual MFI and its situation, but will also take into account the market and economic environment in which it operates, as well as the regulatory regime that governs it.

MBP PUBLICATIONS

MBP publications can be downloaded free of charge from <http://www.mip.org/pubs/mbp-res.htm>. If you don't have access to the web, or prefer a bound copy, publications are available at cost for US\$.10/page. To order, please send an Email to mip@dai.com. For a complete list of publications, send an Email to content@dai-listserve.dai.com.

Working Papers

* Commercialization of Microfinance: A Framework for Latin America, by Jeffrey Poyo and Robin Young (DAI) * Commercialization of Microfinance: Cases of Banco Económico and Fondo Financiero Privado FA\$SIL, by Jeffrey Poyo and Robin Young (DAI) * Commercialization of Microfinance: Case of Multicredit Bank in Panama, by Jeffrey Poyo and Robin Young (DAI), and Jean Steege (ACCION International) * Consultation on Regulation and Supervision of Microfinance: A Workshop Report, by Liza Valenzuela (USAID) and Robin Young (DAI) * Providing Insurance to Low-Income Households, Part I: A Primer on Insurance Principles and Products, by Craig Churchill and Warren Brown (Calmeadow) * Regulation and Supervision of Microfinance: A Conceptual Framework, by Robert Vogel, Thomas Fitzgerald, and Arelis Gomez (IMCC) * Rapid Onset Natural Disaster Technical Briefs, by Geetha Nagarajan (Calmeadow) and Joan Parker (DAI)

Publication Series

* Management Information Systems for Microfinance: An Evaluation Framework, by Andrew Mainhart (DAI) * Marketing in Microfinance Institutions: State of the Practice, by William Grant (DAI) * Village Banks, Caisses Villageoises, and Credit Unions: Lessons Learned from Client-Owned Microfinance Organizations in West Africa, by Korotoumou Ouattara, Douglas Graham, and Claudio Gonzalez-Vega (OSU) * Using Village Mechanisms to Expand the Frontier of Microfinance: The Caisses Villageoises in Mali, by Thi-Dieu-Phuong Nguyen, Korotoumou Ouattara, and Claudio Gonzalez-Vega (OSU) * Internal Account Management: A Toolkit for Village Banks, by Judith Painter,

with John Bronson (Project HOPE), Bill Farrand (CRS), Ken Graber (World Relief), Dennis Macray (Katalysis), Candace Nelson (the SEEP Network), Rosemary Pugh (FINCA), Kathleen Stack (FFH), and Christy Stickney (Women's Opportunity Fund). Funded through the MBP Grant Facility. Available in French and Spanish.

MBP GRANT FACILITY

New Directions

With two years to go in the project, MBP's grant facility is directing its remaining resources to grant programs that field test selected MBP tools, methodologies, or principles being advanced or explored through the research agenda.

Africa: Seeds of Hope Predoctoral and Postdoctoral Field Research Program

The Africa: Seeds of Hope Act of 1998, passed by the 105th U.S. Congress in October 1998, supports sustainable and broad-based agricultural and rural development in sub-Saharan Africa. The Act calls on USAID to reprioritize its assistance in Africa to focus on small-scale farmers and rural entrepreneurs, who represent the large majority of the continent's population. In support of the Act, and to complement our own research on rural finance in Africa, MBP is launching this grant program to support field research on current trends and innovations in using microfinance to improve the capacity and efficiency of agriculture production in sub-Saharan Africa. The competitive program will award grants to land grant and historically black colleges and universities in the United States for field research at the predoctoral and postdoctoral level. MBP will make approximately three university grant awards, through which individual predoctoral and postdoctoral researchers will receive up to \$10,000 for three to six months of field research in Africa. The deadline for university grant proposals is March 20, 2000. For more information and application instructions, visit www.mip.org.

BDS Performance Measurement Framework (PMF) Field Test

In November 1999, six microenterprise development organizations received MBP grants to field test the PMF, developed by MBP and the International Enterprise Program of the ILO, under the auspices of the Committee of Donor Agencies for Small Enterprise Development. MBP selected the organizations through a competitive process and placed priority on selecting programs that represent a wide geographic range and diversity of BDS services. In the 16-month field test, the six field testers constitute a learning network to contribute to the development of standard tools for data collection and analysis, collect and report baseline data using the tools, and assess and modify the PMF according to field experience. The field testers interact on a list-serve, through real-time internet discussions, and in workshops. The field testers are supported by Mary McVay, Alexandra Overy Mielbradt, and Tim Canedo, who will do the legwork in formulating tools and techniques and preparing a final manual on the PMF, using the six organizations' BDS programs as examples. The six field testers, each receiving a \$10,000 grant to defray the costs of participating in the field test, are:

Industrial Enterprise Development Institute (IEDI), Nepal SEEDS (Guarantee) Ltd., Sri Lanka
Canadian Centre for International Studies and Cooperation (CECI), Nepal
Conservation International, Guatemala
Finance and Advice in Development Assistance (FAIDA), Tanzania
Swisscontact-Philippines

Collaborative Learning Program for Microenterprise Networks in Africa

Through a competitive process, MBP awarded grants in September 1999 to five microenterprise networks in Africa to participate in a one-year, structured learning program facilitated by MBP's partner, the Small Enterprise Education and Promotion (SEEP) Network, through their network development services program. With a MBP grant of \$25,000, each network participated in the 1999 SEEP Network Annual General Meeting and will implement collaborative learning and capacity building activities-identified by the networks themselves-that are designed to improve their technical skills and ability to deliver or broker demand-driven services on a sustainable basis. Among the activities identified by the networks is the development and implementation of performance standards, capacity building and information dissemination strategies. In the collaborative learning program, the networks interact through a list-serve and in workshops, including the 2000 SEEP Network Annual General Meeting where they will present results and lessons learned in the program. Sharyn Tenn of the SEEP Network coordinates the program. The MBP-funded networks are among eleven networks worldwide with which the SEEP Network is partnering to provide training, mentoring, and curriculum development. The five MBP-supported networks are:

Association of Microfinance Institutions of Uganda (AMFIU)
Consortium ALAFIA, Benin and Togo
Ghana Microfinance Institutions Network (GHAMFIN)

Joint Consultative Committee (JCC), Namibia
Zimbabwe Association of Microfinance Institutions (ZAMFI)

MBP INFORMATION DISSEMINATION

Website News. MBP has forged a partnership with Africa Online to host a parallel MBP website so that more users in Africa can have easier and faster access to MBP research publications, events, and other resources. An average 6 million people access the Africa Online websites each month, marking a significant increase in outreach for MBP. MBP is looking for similar partnership with major Internet providers in Latin American and Asia. We welcome your suggestions by email at mip@dai.com

MBP Promotion. MBP research was featured at the following public events:

* Risk and Responsibilities-The SEEP Network 1999 Annual General Meeting, Baltimore, Maryland, October 18-22, 1999. Joan Parker and Dave Larson led a workshop on microfinance in post-conflict; Mary McVay presented the revised framework for BDS performance measurement. The Internal Account Management Toolkit for Village Banks and the BDS Business Planning Manual, funded by the MBP Grant Facility, were also presented. In addition, MBP sponsored five African microfinance networks to attend the event.

* 1999 Training Program of the Microfinance Centre for Central and Eastern Europe & the New Independent States. MBP promotional and information materials were distributed to participants.

* ILO-STEP Workshop, Geneva, Switzerland, December 8-10, 1999. Craig Churchill presented the MBP research on insurance provision for low-income households at a workshop on Social Protection for Women in the Informal Sector, sponsored by ILO's STEP (Strategies and Tools against Social Exclusion and Poverty) program.

BDS 2000 Training Programme, July 24-August 11, 2000. MBP research will be an integral component of the BDS 2000 Training Programme organized by the Springfield Centre for Business in Development in Durham, United Kingdom. A copy of the full program is available on the MBP website at <http://www.mip.org/new/new.htm/> and on the Springfield Centre website, <http://www.springfieldcentre.com> For further information on this program, contact Alan Gibson or Rob Hitchins, email: bds@springfieldcentre.com

Calendar of Events

January 28, 2000: MBP Brownbag Series: Strategic Linkages and Network Brokering for Microenterprises, Washington, D.C. Presentation of MBP research by Paul Bundick (DAI) at the Inter-American Development Bank. For more information, contact mip@dai.com

February 14, 2000: MBP Workshop: Providing Insurance to Low-Income Households, Washington, D.C. Presentation of MBP research by Craig Churchill and Warren Brown, Calmeadow. For more information, contact mip@dai.com

February 22-25, 2000 USAID Conference: Advancing Microfinance in Rural West Africa, Bamako, Mali. Keynote presentation of rural finance framework by MBP researchers Hamet N'Dour and William Grant. Presentation of MBP research: Marketing (William Grant, DAI); New Product Development (Monica Brand, ACCION); and Insurance for Low Income Households (Craig Churchill, Calmeadow). For more information, contact Katrena Henderson at khenderson@weidemann.org.

February 28-29, 2000 MBP & CARE/Bangladesh Workshop on Micro-Insurance, Dhaka, Bangladesh. Presentation of MBP research by Warren Brown, Calmeadow. For more information, contact Carlos Ani at carlos@bangla.net.

Date TBD: MBP Virtual Conference on Micro-Insurance. A moderated listserv discussion. For more information, send an email to mip@dai.com

MBP Newsletter

Editor: Nhu-An Tran
Contributor: Jimmy Harris
Layout: Carol Kulski

The MBP Newsletter is a quarterly publication of the Microenterprise Best Practices Project, a USAID-funded project implemented by DEVELOPMENT ALTERNATIVES, INC. in collaboration with ACCION International, Foundation for International Community Assistance, Harvard Institute for International Development, International Management and Communications Corporation, Ohio State University Rural Finance Program, Opportunity International, and the Small Enterprise Education and Promotion Network.

To make comments and suggestions, or to be included in our mailing list, please write to:

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Date sent:	Sun, 20 Feb 2000 18:38:11 -0600
Send reply to:	devfinance@lists.acs.ohio-state.edu
From:	Mark Schreiner < schreiner@gwbmail.wustl.edu >
To:	devfinance@lists.acs.ohio-state.edu (Development Finance Network)
Subject:	Good Impact Studies I: New bank branches and savings in Mexico

There is a very interesting study of the impact of new bank branches on financial savings by low-income households in Mexico:

Aportela, Fernando. (1998) "Effects of Financial Access on Savings by Low-Income People", manuscript, Massachusetts Institute of Technology, aportela@mit.edu

In 1993, a government financial institution (Pahnal) opened new branches in some towns already with Pahnal branches and in some towns without Pahnal branches. The Mexican National Survey of Income and Expenditure measured the savings rate for about 9,000 households in 1992 (before the new branches) and then again for about 9,000 other households in 1994 (after the new branches).

The branch expansion is a "natural" experiment; savers in towns with new branches are treatments, and savers in towns without new branches are controls. Aportela focuses on the the savings rate, defined as (Household Income - Household Consumption)/Household Income. Because the survey chose households at random, there is no reason to think that the joint distribution of observed and unobserved characteristics that might affect the saving rate would differ between treatments and controls. As long as Panhal decided where to put branches without considering the expected savings rate of households, any differences in average savings rate between treatments and controls can be attributed to the new branch.

The new branches also offered savings contracts whose design was based on the experience of BRI in Indonesia. For example, the accounts offered unlimited withdrawals and had no withdrawal fees or minimum balance. Furthermore, depositors were entered in monthly lotteries. One contract was meant to mimic the Mexican version of the RoSCA. It required monthly deposits and allowed withdrawals only after 12, 24, or 36 months. About 74 percent of accounts opened were simple passbook accounts. The average (median) balance for all the new types of accounts in 1994 was about \$300 (\$100).

The four most relevant findings were:

1. Compared to towns without new branches, towns with new branches had a median household savings rate that was 3 to 5 percentage points higher.
2. The savings rate increased most for the poorest households and least (about zero) for the richest households.
3. Increases were highest in towns where the new branch was also the first branch.
4. Less conclusively (and counter-intuitively to my mind), the data could not rule out the possibility that all of the increase in savings was due to new savings rather than due to reshuffling of existing assets, say, from the form of concrete blocks or sacks of grain to the form of bank balances.

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Date sent:	Sat, 26 Feb 2000 09:11:53 -0700
Send reply to:	devfinance@lists.acs.ohio-state.edu
From:	"Dale W Adams" <dwadams@burgoyne.com>
To:	<devfinance@lists.acs.ohio-state.edu>
Subject:	Inaction on savings mobilization

I've heard various arguments to justify inaction on deposit mobilization.

1. For many decades development doctors argued there was no need to provide attractive deposit services in depressed areas because people there were too poor or too unsophisticated to save -- what these people needed was more debt. The results of research on self-help financial groups (roscas and ascra) is a difficult and bitter chew for those who hold these views.
2. Fervent microdebtors employ a variant of the too-poor-to-save argument: all poor people need more debt which, in turn, will solve most poverty. They go on to argue that only specialized (and subsidized) non-governmental organizations have the compassion to supply this debt. They lament that the gaggle of ngos created by this strategy is not allowed to mobilize deposits by central monetary authorities, but conclude this is a small price to pay for solving poverty through debt.
3. Based on analysis of flows-of-funds through financial markets, other observers argue that if poor people place their money in formal deposits these funds would flow out of depressed areas, instead of being available for local lending. Those holding this view ignore that savers always outnumber borrowers, that depositors benefit from these services, regardless of where their savings are ultimately lent, and that the overall economy benefits from this transfer of funds among regions.
4. Mike Gudger raised an even more forceful argument. He felt it is unfair to encourage poor people to place their savings in financial institutions because these deposits are then sometimes exposed to an inflation tax. Only when pressed would Mike admit that, given their limited alternatives to save, deposits might still be an attractive option for poor savers, even with the threat of an occasional inflation tax.
5. In a recent dfn posting Peter restated still another argument for inaction on deposit mobilization: it is too costly to mobilize small deposits. His argument merits further debate.

Did the Germans use some kind of magic 150 years ago to overcome this cost problem when they successfully began to mobilize small amounts in deposit accounts? Did the Japanese use similar slight of hand about the same time to mobilize large amounts of small savings? How about BRI? Can only Dick Patten mix the brew that caused deposit mobilization to be a hugely profitable activity there? Why can zillions of humble people around the world mobilize small amounts successfully through roscas and ascra without being overwhelmed by costs? Do they know some magic that is impossible for development doctors to comprehend?

Some bright and dedicated people have discovered how to make small loans to poor people and realize a profit in the doing. If similar efforts were applied to the deposit side of finance, I wonder if mobilization costs could be likewise reduced? Is there an 11th Commandment I haven't read? Does it say that the costs of mobilizing small deposits is high and fixed and can never, ever be lowered? Is the microdebt industry, associated subsidies, and rent seeking crowding out efforts to discover ways to mobilize small deposits efficiently?

Would those of us who live off the grants economy maintain their pessimism about deposit mobilization if there were multi-million dollar contracts available for promoting such savings?.....jane.

Date sent: Tue, 15 Feb 2000 12:04:23 -0800
Send reply to: devfinance@lists.acs.ohio-state.edu
From: "Didier Thys" <dthys@freefromhunger.org>
To: <devfinance@lists.acs.ohio-state.edu>
Subject: RE: Roscas in Trinidad and Tobago

Peter,

Bars in Belgium! No you're talking my language!

Regarding your question on commercial accounts, I don't have data for the population at large, but John Caskey did an interesting study for the Filene Research Institute's Center for Credit Union Research entitled "Lower Income Americans, Higher Cost Financial Services". Caskey has already been cited several times on the network regarding his book "Fringe Banking: Check-cashing Outlets, Pawnshops, and the Poor" which is one of the better works on finance and the poor in America.

In this particular study, he looked at the financial practices of people with incomes under \$25,000 per annum. The survey covered 900 people selected from 3 cities in three different states (students and retirees were not part of the sample). Key findings were:

1. one in three respondents were members of a credit union
2. one in five respondents had no deposit account in a bank, savings and loan, or credit union.
3. Check cashing outlets are used by a significant minority of households
4. Money orders are a very popular means of payment among modest households with 28% using them regularly
5. About 50% of the households had a credit card
6. one in twenty households had a personal loan from a credit union in the past year, compared to one in ten having personal bank loans and one in ten using finance company loans
7. One in ten lower-income households used either a pawnshop in the past year or a rent-to-own business within the past two to three years
8. where permitted by regulation, about one in twenty-five lower income households used a check cashing outlet for a payday loan (advance against anticipated paycheck).
9. In states where regulations allow it, title pawns are growing very rapidly. With these loans the borrower uses a car for collateral, and gives the lender the title along with the power of attorney which allows the lender to transfer title to himself if the borrower defaults
10. the alternative financial sector offers expensive services with credit typically at 50% to 300% APR. Lenders charge such high rates primarily because their services are expensive to deliver.

Very interesting read along with "Fringe Banking" if you want to find out about financial services for low-income consumers.

Date sent: Sat, 26 Feb 2000 07:44:07 +0600
Send reply to: devfinance@lists.acs.ohio-state.edu
From: Carlos Ani <carlos@bangla.net>
To: devfinance@lists.acs.ohio-state.edu
Subject: Informal finance in India

I am forwarding this post from Imon Ghosh of Calcutta India regarding the topic of informal finance in India, to respond to Thorsten Giehler of FAO. - Carlos

From: "Imon" <imon@vsnl.com>
To: "Giehler, Thorsten (AGSM)"
Cc: "Sharenet" <sharenet@egroups.com>
Subject: Re: [sharenet] Informal finance in India
Date: Fri, 25 Feb 2000 13:07:25 +0530

Dear Thorsten,

If India is to achieve balanced economic growth, stem rural-urban migration, and mobilize vast untapped resources, then initiatives will need to be taken to broaden and deepen the rural markets for financial services.

We simply cannot have national development without rural development, especially with 7 out of 10 Indians (... that's around 700 million people) still living in rural India.

As Nimal Fernando at the Asian Development Bank, Manila, pointed out in a recent Sharenet posting (the "Missing Middle"), rural economies today are much more diversified than they were 20 years ago, and rural non-farm enterprises are more important in terms of their contribution to rural incomes and growth.

Rural markets for financial services will therefore need to address diverse needs ... preferably - I still maintain, with low cost credit (that isn't calculated in the hundreds, or thousands, of percent !) - and thrift instruments that facilitate savings.

You are right about NABARD's and the Reserve Bank of India's terms being unattractive to indigenous bankers. The problem isn't just with unattractive profit margins, but also with the conditionalities that are attached to the refinance. Since 1935, when the RBI was established, several attempts have been made by the Reserve Bank to bring the indigenous bankers under its orbit of influence.

The Reserve Bank issued a draft scheme for establishing direct links with India's indigenous bankers. In it, the Reserve Bank suggested that the indigenous bankers should give up their trading and commission business, switch over to a western system of accounting, develop the deposit side of banking activities, have their accounts audited by certified accountants and submit to the Reserve Bank a periodical statement of their affairs.

In addition, the Reserve Bank wanted the ambiguous character of the hundi to cease and insisted that it should become a negotiable instrument always representing a trade transaction. The RBI also wanted the larger of the indigenous banks to play the role of discount houses (buying and selling bills of exchange, etc.) as in London.

In return for trading away 5,000 years of tradition, and the acceptance of a few humiliating controls, the Reserve Bank promised to provide the indigenous banks all the privileges enjoyed by the scheduled banks !

The indigenous bankers, with their age-old traditions of independence, declined to accept the restrictions as well as the compensating benefits of securing accommodation from the Reserve Bank on favourable terms.

They disagreed with the suggestions regarding accepting deposits and giving wide publicity to their accounts and their state of affairs.

The indigenous banks were unwilling to give up their trading and commission business, and confine themselves to banking alone. They did not believe that the privileges offered by the Reserve Bank were adequate enough to compensate for the loss of their non-banking business.

As a result, the scheme proposed by the Reserve Bank to bring the indigenous bankers under its direct influence regrettably fell through.

The Banking Commission (1972) added a few twists of its own. It declared that indigenous bankers should preferably be members of an association; have minimum prescribed capital requirements of at least Rs. 100,000/-.

A summary statement of the volume and nature of business should be furnished annually by each indigenous banker to the Reserve Bank of India.

It's interesting to observe that the Banking Commission has repeated all the suggestions that have been made since 1935 for linking indigenous bankers with the organised banking system. However, the Commission appears to have forgotten the fact that the indigenous bankers have been unwilling all these years to accept the terms the Reserve Bank has chosen to offer.

Having (... with one interesting exception) been treated with undeserved contempt by the modern, largely westernized financial sector led by the Reserve Bank of India, it's hardly surprising that the RBI's influence with India's indigenous bankers has regrettably been limited.

The key to reversing this unhappy situation lies in cultivating and demonstrating greater respect for the rich heritage, and continuing contribution, of India's traditional financial sector.

An important lesson can be learnt from the State Bank of India's predecessor, the Imperial Bank of India, which achieved a measure of influence in the early years of the 20th century with the indigenous bankers (even influencing the interest rates they charged) which had never been achieved before, and hasn't been achieved since. The Imperial Bank

of India achieved its unprecedented influence simply by respecting the indigenous bankers age-old ways of doing business, and offering them rediscount facilities without cumbersome conditionalities ...

You asked whether rural moneylenders in India are interested in providing credit for investments, and willing to extend long-term credit. These are relevant questions.

India has numerous rural moneylenders (and several kinds of indigenous bankers) so it probably won't be possible to generalize. However, the Keecheri Welfare Bankers of Ernakulam district in Kerala is known to have extended credit for investments on numerous occasions.

Dr. Rengarajan has shared in a recent posting that the Community Credit Facilitators (CCFs) in Sri Lanka made loans to rural clients with a repayment period of 60 months and a grace period of 12 to 18 months.

I was also interested in Mahinda Gunasekera's observation that the formal and semiformal sectors meet only about 3 percent of the informal sector financial needs in Sri Lanka.

So, to answer your question about whether rural moneylenders would really have a demand for refinance facilities, I believe they would if they have the financial incentives to on-lend profitably, and make a buck in the process.

Your concerns about creative rent-seekers where public money is involved is entirely justified. One controversial study from the highly regulated '70s estimated that as much as 40% of India's GDP at the time could be accounted for by rent-seeking activity ... and I'm of the view that all public sector monopolies (the Indian public sector has over Rs. 1,400,000,000,000/- sunk in it) ought to be classified as rent-seekers - devoid, perhaps, of the creativity.

Thanks for recommending the recent FAO & GTZ publication on "Sources of Funds for Agricultural Lending". I look forward to reading it.

Best regards, Imon

Date sent:	Thu, 24 Feb 2000 04:44:50 +0600
Send reply to:	devfinance@lists.acs.ohio-state.edu
From:	"SRINIVASAN" <gsns@vsnl.com> (by way of Carlos Ani <carlos@bangla.net>)
To:	devfinance@lists.acs.ohio-state.edu
Subject:	Informal finance in India

Dear Carlos,

Thanks for the interesting posting. I have read Imom's paper with interest.

APRACA members,(India is one of the members), considered the problems of the poor in accessing credit from the Formal financial institutions and debated on two alternatives way back in 1986 - one to finance the poor through the money lenders and another to finance them through informal networks, self help groups, solidarity groups etc.,Majority voted for the second which has seen the grounding of financing through the informal groups to the poor.

This has led to the SHG - bank linkage programme in India where usually the NGOs form the self help groups of poor: the groups mobilise the small savings of the poor and lend the money among themselves: on successful operation for more than six months the groups are linked to local formal financial institution for financing. The programme aims at using the existing bank network to lend to the poor by making the poor bankable. SHGs not only aim at financial intermediation but also building of social capital. NGOs help poor to identify their common needs and build their capacity to address their needs. Social and economic empowerment can take place in this model. This model has been functioning for the last eight years and eighty percent of the groups financed consist of women. As far as the Indian micro finance scene goes the SHG route is the predominant model.

I have been involved in many studies on the efficacy of the SHG linkage programme which bring out the following facts.

Poor as members-

There are levels of poor as per the severity of poverty they are facing. For simplicity sake let us categorise the poor into three - hard core, medium and better off. The hard core poor are rarely the members of the SHGs. Due to a variety of reasons -including their doubts in their ability to regularly save, their hesitation to participate in mixed caste groups, the apathy of NGO workers to make special efforts to mobilise them - they are not usually forming groups.

Financial performance -

Wherever the hard core poor are in groups these groups differ - in their savings mobilised, credit rotated and the usage of credit. Savings mobilised is smaller, lending is for smaller amounts and the usage is for consumption purposes. The groups which consist of medium and better off poor mobilise more savings, revolve more credit and usage of loans shifts from consumption to production purposes. In many of the groups some hard core poor are also present. They are usually agricultural labourers. Their ability to use the loans for productive purposes are limited since they are hesitant to take up other income generating activities.

Savings mobilisation -

The members value the opportunity provided by the groups to mobilise the small savings. This is often cited as one of the good impacts by the members.

Usage of loans -

The members use the loans for a variety of purposes. In the initial years loans are taken up for consumption needs but change over a period of time to more of production -Purchase of dairy animals, goats, sheep, agricultural operations, small businesses, trading etc., Given the fact that about eighty percent of the groups are women groups, they use the loans not for just the activities to be taken up by them but use the loans for family needs. More often the loans are used to finance the activities taken up by the husband or jointly.

Additional income -

The addition to income is limited since the loans finance usually the existing activities. However, the members get cheaper loans from SHGs. SHGs provide loans at 24 percent per annum usually where as the earlier source had been much more costlier upto 120 percent per annum. This has resulted in cost savings and addition to income. New activities, expansion of activities or change of practices do happen but rarely.

Freedom from money lenders-

The members continue to borrow outside the groups but for lesser amounts and less frequently. Many of them proudly say that their SHGs fulfill their needs. Borrowing from outside is usually for very short term from friends and relatives and long term and larger needs - housing, marriage- from money lenders. In some of the villages where the SHGs are well grounded the interest charged by the money lenders have come down.

Growth of SHGs -

The finances of some of the old SHGs have grown to such an extent, many of them don't require any outside funding support. Their corpus consisting of savings, interest earned from loans made etc., are sufficient to take care of their members' requirements. Wherever federations of SHGs have emerged they act as financier of the groups and they are unit banks operating in a cluster of villages.

Thus the issues which emerge are In order to bring about rural development and improve the income of the poor very concerted efforts need to be taken in developing infrastructure so that more opportunities for Income generating projects arise. Even with provision of timely credit as SHGs are providing, the members are able to take up income generating activities which definitely bring in additional income but not enough to make a quantum jump.

Different strategies need to be thought of to address the needs of the different categories of poor. Addressing the needs of hard core poor and to bring about changes in their lives is a challenge even through the mechanism of SHGs. Money lenders can hardly address their needs.

Providing credit alone is not sufficient. Mobilising the savings of the poor is equally important. SHGs, banks, MFIs are required for this. Poor value this service.

Poor require a variety of sources for funding their needs. They do not like to stick to one source just as the way any of us like to keep our choices open. Creating the choices and alternatives is more important. Competition brings in efficiency and better quality of services.

Passions run high against the money lenders. The first rural credit survey commissioned by Reserve Bank of India in 1954 mentioned that the banks need to open more branches in the rural areas to put the money lenders in their places. This has not been achieved. Almost after 40 years only 64% of credit is from formal institutions. 36% of credit is accessed from informal sources. Money lenders have a useful role to play in the informal market. But they also have vested interest in making their clientele remain their clientele for ever. They are not development oriented. It will be really worthwhile to learn more about this from Sri Lanka.

In Sri Lanka People's bank has experimented with financing of pawn brokers. Interaction with some of the officials of the bank shows that the scheme is not replicated even within Sri Lanka. Sri Lanka has also experimented with a scheme where funds were to be provided to persons of proven credit worthiness usually on the basis of collateral. The

appointed persons would get the loans at 18 percent per annum and are expected to lend to small farmers at rates less than 30 percent per annum. Getting people who are not motivated by profits alone but also by social purpose has landed the scheme in difficulties. It will be useful to get to know more about the Sri Lankan experience.

The solutions have to be looked at each level.

As far as the formal financial institutions are concerned, reviving the rural co operative banks, political will to encourage good repayment of bank loans and encouraging banks to charge interest rates which would cover their costs would go a long way in meeting the requirements of better off poor. Encouraging the banks to lend to the poor through self help groups and federations wherever they exist, will help both the banks and the poor in all three categories. Finally, we need to look at alternatives which are development oriented.

Regards,

Girija Srinivasan

consultant - micro finance

gsns@vsnl.com