

ANNEXES

To the Devfinance quarterly Review

July-September 2000

General Information

➤ [Report on ILO workshop in Uganda](#)

Outlook

Anyone interested in the topic and in getting involved should recognise the dynamism in this line of 'financial products' with diverse approaches and growing experience to consider. ILO is one approach that leaves open a number of questions as do other approaches.

This ties in with MicroSave's work on setting up a Centre for Microinsurance as well as other international developments such as the CGAP working group in the process of being established and WIEGO action research and networking. A clearing house such as the proposed Centre that can provide information, analysis, and debate that is not tied to any one approach or interest would certainly be a great value added to further evolving in different types of (quasi) insurance financing.

A key role for donors can be support to the cost and risk of product development and pilot testing through direct financing and/or underwriting. It will be important to do this with a design that collects data necessary for insurers to consider underwriting and engaging them early on.

ILO Workshop in DSM, July 2000

Workshop participants came from Kenya, Ethiopia, Uganda, and Tanzania (in order of # from least to most present). The group represented considerable expertise in microfinance and/or micro'insurance' in those countries, particularly health schemes from or with NGOs, MFIs, hospitals, and a donor. The trainers were Marc Socquet and Kees van der Ree (ILO Geneva - STEP Programme), and Annette Schaap (ILO, Training Centre Turin) supplemented with presentations of experiences by a couple of resource persons and participants.

The focus was on promoting the ILO STEP approach of community- or group-managed schemes. The material presented by ILO was in parts interesting, stimulating fruitful exchange of experiences and approaches among the participants; in parts, however, it was too generic or basic to be useful, e.g. a one hour lecture on the evolution of social security systems in Europe and North America.

The ILO group-based approach is one among a variety of approaches of microinsurance schemes. To date most schemes focus on either life or health insurance. The workshop focused on health with brief presentations on some models and experiences with life insurance. I was left with the impression that the experience with the ILO approach is still in its early stages also limited in terms of size -- few and small groups participating in the pilot schemes.

The basic issues are accessibility and quality of health care. The ILO approach clearly stems from a philosophy of community or self-help group-managed solutions to public sector or welfare system gaps in social protection such as in health care. Hypotheses are that, especially in rural settings or the urban low income communities, groups (community groups such as burial groups or associations, eg. of microbusinesses) are best placed to manage a microinsurance scheme and can bear pressure on the health unit and/or other local health care providers to improve the quality of their services.

Some Points for Reflection

>> Insurance, savings, risk pooling

The terminology of insurance or microinsurance can be misleading. Insurance is a regulated industry with requirements that likely most microschemes are far from being able or even wanting to meet. Schemes that are actually user-fee-savings-groups are not insurance but a form of liquidity management and risk pooling. ILO's terminology of 'mutual health protection schemes' or 'community/group-based health financing' reflect this distinction.

Whether a health care savings scheme has a function of quasi insurance depends on what it covers. If the services are clearly capped, the emergency or disaster an insurance is often intend to cover, will not be covered. For instance, some hospital schemes exclude inpatient care and thereby cordon off the area of highest financial risk.

>> Spectrum of different approaches with different philosophies and implications

From a risk allocation perspective, the spectrum for micro-health insurance schemes runs from group-managed to provider-based to insured/underwritten. These can be initiated, attached to, or marketed through NGOs, projects, health units, Ministry of Health, health providers, MFIs, or insurances.

Self-managed group schemes offer a savings pool to cover e.g. health unit user fees. The contributions to the savings pool can be determined by looking at the average use, the cost of user fees, and, if necessary, capping the service to a certain number of visits or, where there is no user fee, capping the types of services covered. Measures of adverse selection are also critical. One common solution to this is the requirement of a minimum of 60% of the group (e.g. burial group) or business association has to 'subscribe'. An additional mechanism is a waiting period between entry into the scheme and eligibility date for first use of services.

Provider-based schemes tend to be offered to groups rather than individuals to account for adverse selection. They tend to clearly define the services covered. In its most financially conservative form, this approach is a form of pre-payment with some cost-sharing by the participants. The provider will be careful to set the contributions to cover costs.

Ideally a provider seeks risk protection through some form of underwriting, be it from insurance or from a donor fund for instance. Their 'insurability or underwritability' is likely much higher than that of groups, especially low-income groups.

>> Feasibility, sustainability, and market segmentation in social protection

Risk pooling, risk profiling, adverse selection, etc. all invite reflection on broader targeted schemes. When fees are pre-set or services can be clearly capped, expanding to other income groups could conceivably improve risk management through size of revenues to the scheme on the one hand and through diversification of the risk profile of members on the other.

Reducing cost of marketing and collection of contributions is another aspect. Business associations and MFIs are excellent entry points for any scheme in that regard, as well as regards implementation of rules of adverse selection.

Some Open Questions

Open questions are many, but here are a few that emerged especially with the workshop focus on group-managed approaches:

- What is the liability scenario in case of 'over-use' e.g. epidemics? (what do the agreements between the community groups and health units, for instance, stipulate?)
- Is the group-managed payment of medical fees compatible with medical code of ethics (e.g. doctor - patient confidentiality)? In the ILO approach, the group sees a fee invoice per member visit.
- Have the pilots been successful in communicating the concept? Do people understand their rights and risks? Some experiences in Uganda and Tanzania suggest confusion and basic questions. One difference, as one

discussant put it, seems to be that people have a shared value regarding helping out with funeral expenses but not the equivalent value re: shared health care cost.

- Under what conditions can the approach be sustainable?

Can the groups be sustainable without a parallel support system providing a monitoring and support function re: group and health provider accountability (financial and medical; e.g. controlling overprescription or expensive prescriptions -- insurances have medical doctors to check claims) ? Or can they be better integrated with other 'systems', e.g. where available MFIs for accountability in collection and provider payment?

Is a small savings pool of a group sufficient or would the pool have to be enlarged by forming larger pools from grouping together the small pools?

Does it work in the case of paying actual services as well as in the case of (subsidised) user fees?

How does the political environment affect the schemes, e.g. in Uganda promises of free health care?

Kampala, 1 August 2000, Cerstin Sander, cerstin.sander@ezkampal.bmaa.gv.at
(Perceptions of the author not opinion of the employer.)

- **Outreach of micro-finance (1 mail)**
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<p>From: nfernando@adb.org [SMTP:nfernando@adb.org] Sent: Mittwoch, 30. August 2000 08:39 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Microfinance Clients</p>
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Indonesia and Bangladesh has achieved a significant outreach in microfinance. Look at the following numbers.

Indonesia:

The number of poor people is estimated at about 34.0 million. The poor households may be about 7.0 million.

BRI- Units had 16.6 million simpedes accounts in May 2000. If we assume that 30 percent of these belong to the poor households that would be about 4.98 million households. The average deposit size (outsatnding is about \$75 (about 7 percent of GDP per capita) , hence this may be a reasonable assumption.

BRI-Units had 2.5 million Kupedes (general credit) loan accounts. The average loan size is about \$600 (54 percent of GDP per capita). Again if we assume that 30 percent of the accounts belong to poor households, that would be about 750,000. Here we assume that they do not have savings accounts (which is spomewhat unrealistic).

BPRs reach about 4.2 million people. We assume that 40 percent of this is poor households. Then it would be about 1.68 million households.

BKDs and LDKPs reach about 2.0 million, and we assume that all are poor.

When we add all these we get about 9.41 million households. We know our numbers are not refined. There is obviuosly double counting etc. But still with some discounting for these, it seems that most poor households have access to microfinance services in this country.

Bangladesh:

The number of poor is estimated at 60.0 million (47 % of the population); this in terms of households may be about 12.0 million.

Outreach of MFIs at the end of 1999 (mainly according CDF Statistics) is:

NGOs: 6.89 million borrowers

Grameen: 2.2 million members

Various Govt programs: (assumed): 1.0 million

These add up to about 10.09 million. Take 70 percent of this as true clients. Then it would be about 7 million.

This means about 59 percent of the poor households may have access to microfinance services in this country.

One can raise so many questions about these numbers. But still undoubtedly these two countries have achieved massive outreach.

We need to know more about multiple access, households who are only savers, households who are only borrowers; the average number of clients per household; the proportion representing so-called non-target group etc. In fact we need to pay more attention on the clients and details of their access patterns/behaviours etc. More research on MFI clients and more refined data are certainly needed.

I would like to hear about these numbers and related issues.

Nimal Fernando

Publications

➤ [Book review: Dollar Diplomacy \(1 mail\)](#)

<p>From: J. D. Von Pischke [SMTP:jdvp@erols.com] Sent: Samstag, 19. Februar 2000 03:35 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Book review re: Dollar Diplomacy</p>
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Structural adjustment lending was the brainchild of Stanley Please at the World Bank in the early 1980s.

Right or wrong?

Right—structural adjustment lending was a new term and a new operation for the Bank.

Wrong—structural adjustment efforts were undertaken by the French and British in the 1800s and by the Americans in the early 1900s in poorer nations over which they had or gained some control.

Emily S. Rosenberg's *FINANCIAL MISSIONARIES TO THE WORLD: THE POLITICS AND CULTURE OF DOLLAR DIPLOMACY, 1900-1930* (Cambridge: Harvard U. Press, 1999) explores the history of US efforts to rationalize economies of Latin American and Caribbean republics and in countries in other areas through dollar diplomacy—dollars instead of bullets.

The American motivation rested on the Monroe Doctrine of 1823, which was meant to discourage European meddling in the Western Hemisphere. However, some Latin American republics tapped the international bond markets and subsequently defaulted, drawing or threatening to draw European navies to Latin America (gunboat diplomacy) as part of collection efforts. Americans also saw that Latin dictators often raided their national treasuries (fatted primarily by customs receipts and inflated currency) and felt that the inflation and other problems this created contributed to unrest and lack of economic and social development.

Hence, if the gold or gold exchange standard could be implemented, with gold reserves kept in New York, and if American technicians could be given control of customs revenues in the countries concerned and posted as fiscal advisors or controllers, and if trade could be facilitated, progress would occur. Democratic leadership would emerge, fiscal responsibility would attract investment, and trade and investment would make poor republics blossom, uplifting local culture and society.

Bond defaults could be cured by new issues, managed by private banking houses in the US, with proceeds earmarked for refunding old obligations and for specific new projects such as railroads and other physical infrastructure that would be developmental. These projects often involved American equity investors, too. This was the outline of dollar diplomacy.

The concept had a number of variations in practice. These included military occupation in a few cases and efforts to extend the concept to China, Persia, Poland and also to Germany when it defaulted on reparations following World War I.

Rosenberg outlines and criticizes the concept and shows how its implementation slowly degraded and was eventually ended, other than in the three countries under US military occupation, by the Depression that was well underway by 1930. She also describes how anti-banking and anti-imperialist interests in the US contested dollar diplomacy.

My conclusion is that structural adjustment lending and IMF conditionality are in fact largely rebundled dollar diplomacy, with a new twist or two. As these age, they face the same problems that led to the decreasing effectiveness of dollar diplomacy because the same dynamics are at work. In the case of dollar diplomacy as it was applied in some parts of Latin America and the Caribbean, considerable (well-deserved) enmity was created against the US, and lingers even today. To date, structural adjustment seems to have created less.

Rosenberg views dollar diplomacy through an anthropological lens, spending a lot of time on hierarchy, gender and race. Financial details, such as loan amounts, interest rates and other terms and conditions of deals hammered out between well-meaning minions of good old Uncle Sam and devious, indolent Latino autocrats are not gone into very deeply. (This was the way many Americans saw it at the time. Rosenberg shows that there were at least a few American scoundrels at work, too, along with some others who were merely clueless.) The delicate intermediary role of the State Department in brokering private deals with foreign governments is explored in some detail.

She provides some insights into why those on the receiving end were willing, at some point, to become involved, an element that I do not believe has been sufficiently explored in the debates over structural adjustment. Why do governments agree to go along with the Bank and IMF? Are they so easily bought, and if so, what are the terms and conditions and local expectations.

And if you wondered what the relation was between the erotic aspects of a sun tan, baseball, Teddy Roosevelt's stalking lions in Africa and exploring the upper reaches of Amazonia, Tarzan and Jane, US Marines' womanizing with the locals, on the one hand, and progress or lack of it in poor countries importing dollar diplomacy on the other, this book offers you some hypotheses. The book is assembled from previously published articles and as a result has lots of redundancy, saying the same thing over and over, making the same point in different places, etc. New institutional economics would offer a sounder basis for interpretation, but sharper analysis might come at the expense of duller reading.

All in all, an interesting read on what now seems a somewhat bizarre episode in international finance, but which contained expectations, impositions and denouements echoed in current efforts at structural adjustment. Prejudice has clearly decreased, but lots of efforts to promote ³development² continue to be like ships that silently pass in the night.

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Subjects of interest

➤ [Banking Regulation Contra Microfinance... \(8 mails\)](#)

From: Dale W Adams [dwadams@burgoyne.com] Sent: Sunday, 2. Juli 2000 07:04 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Savings and Development
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The latest issue of <<Savings and Development>> (Vol. 24, No. 1, 2000) has the following articles in it:

1. Impact of Dividend and Retained Earnings on Stock Prices in Bangladesh: An Empirical Investigation.....by M Farid Ahmed.
2. Exploring Segmentation in Rural Financial Markets: An Application in El Salvador.....by Henk Moll and others.
3. Production Credit for African Small-Holders: Conditions for Private Provision.....by Ann Gordon and Andrew Goodland.
4. Internal Saving Surplus and Debt Service Possibilities.....by M. Gulcz.
5. Poverty, Rural Financial Institution Building and Gender Sensitive Demand Analysis in the North-West Province of Cameroon.....by G. Shrieder.

Numbers 2 and 6 especially tweaked my interest.

Moll et. al. use the notion of 'segments' to organize their thinking about rural financial markets in El Salvador. Many other authors use the notion 'fragmented' to describe the diversity they see in similar markets. I'm uneasy with fragmentation arguments. They often lead to the conclusion that these markets are imperfect, harbor major doses of monopoly power, and need government remedies. I'm less uneasy about the term segments; it doesn't carry the negative connotations that the term fragmented does. Still, I don't feel the neutral term segments adequately describes what one finds in most rural financial markets. In my opinion, the diversity in providers of financial services, differences in financial products, and clustering of clients around various providers are largely marks of specialization. For example, some providers of financial services specialize in taking physical possession of collateral (pawnbrokers), «write» extremely simple loan contracts, and attract clients who want small and short-term loans quickly. Isn't that specialization and isn't this a good thing?

Schmidt points out that the microdebt industry faces the problem of being regulated. The industry is on the horns of a dilemma: if it wants to expand its range of financial services to include deposit mobilization, it must be supervised and regulated. At the same time, extending to ngos the traditional regulation and supervision applied to banks is likely to asphyxiate many of these fledgling organization. Schmidt rightly points out that traditional size or capital requirements may be the most threatening aspect of regulation and supervision. I'm unaware of any country that has tailored an effective, yet nurturing, set of regulations especially for the microdebt industry. Have I missed something?.....ossified jane.

<p>From: Beatriz Marulanda [bemarula@cable.net.co] Sent: Wednesday, 5. Juli 2000 13:58 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Savings and Development</p>

Regarding the regulation issue, Bolivia is an interesting example of a country with a special regulation regarding the microfinance industry. They authorized the creation of the «Fondos Privados (after Banco SOI was created) with a minimum capital requirement much lower than the one for banks, but this was combined with a regulation that requires a greater dissemination of risk by credit, that is, the limits to offer credits without guarantees as a proportion of its equity are much lower. They are then authorized to mobilize savings. Under this authorization, the consumer lending business has also flourished. An interesting case!!

Beatriz Marulanda

<p>From: Alfred Hannig [SMTP:alfred_hannig@hotmail.com] Sent: Freitag, 7. Juli 2000 12:43 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Savings and Development</p>

Dear all,

Schmidt is right if he stresses the threatening aspect of „traditional" regulation and supervision for microfinance as long as it is not adjusted to the specific financial technology and institutional setup of this industry. There are only very few examples where MFIs managed to take the hurdle and actually get a banking license (e.g. BancoSol in Bolivia and K-Rep Bank in Kenya). This will not be the general solution for most of the MFIs that would like to go into the deposit-taking business and therefore must be regulated.

However, there are some promising examples of the adoption of special laws for the microfinance industry (not for the microdebt industry as Jane wrote since they do not have to be regulated in the first place) . The Fondos Financieros Privados (Private Financial Funds) in Bolivia and the Entidad de Desarrollo para la Pequeña y Microempresa (EDPYME) in Peru could be mentioned here.

Here in Uganda a so-called Microfinance Bill is proposed that caters for the specific requirements of Microfinance Deposit-taking Institutions (MDIs). Implementation of this bill, as it is currently discussed, could follow the approach of

risk-based supervision, i.e. concentrate on institutional aspects such as quality of corporate governance and management, business policies and procedures, effectiveness of internal controls, and the adequacy of MIS of microfinance operators instead of focussing on an amount of data generated from costly reporting systems. Quantitative analysis, i.e. financial ratios will still play a role but will have to be understood as complementary within this framework of risk-based supervision. And the proposed regulatory framework will only provide for those MFIs with a track record and those which at least reach operational self-sufficiency. Deposit-taking is a demanding business and one should not make the mistake of prematurely allowing it the larger crowd of microdebt-NGOs that do not have the necessary experience, skills, governance and ownership structure etc. They will not be affected by this Bill as long as they do not mobilize and intermediate deposits (from and to the public). Thereby, the restricted capacity of regulators and supervisors also often observed and commented on elsewhere will be taken into account.

Alfred Hannig/Stefan Staschen

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From: SRINIVASAN [gsns@vsnl.com]
Sent: Tuesday, 27. Juni 2000 07:14
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Savings and Development

I guess that NGOs do not want to be regulated in anyway. How microcredit institutions become so special as not to deserve regulation or attract a different, benign form of regulation. Institutions which deal with small savings and credit need stringent regulation as they have the potential to wipe out people who have very little to lose. There is no point in fighting shy of either capital adequacy norms or regulatory rigour, if serving the micro and tiny is the objective. Even small sized operations which collect deposits from people should be subject to regulation from the point of view of depositor protection.

N.Srinivasan

From: Fiebig Michael [Fiebig@Bankakademie.de]
Sent: Monday, 10. Juli 2000 19:48
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Regulation: The good and the bad guys

Dear Alfred and Stefan,

Ensuring that only the « good guys » enter the regulated (deposit-taking) microfinancial marketplace is one - good - thing. But how will you ensure that good guys do not turn bad? In other words, on-going supervision will also have to focus on qualitative aspects much more than quantitative ones, i.e. risks instead of ratios only. This, of course, implies again a certain degree of technical excellence and capacity on the supervisor's side. It will also imply supervisory costs. And then, who will cover these costs? Will the registered MFIs contribute to the supervisor's budget? Or do you consider it as production of a public good, which the public budgets will have to finance?

With best regards,
Michael Fiebig,
Micro Banking Competence Center
Bankakademie

From: Alfred Hannig [alfred_hannig@hotmail.com]
Sent: Tuesday, 11. Juli 2000 12:22
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Regulation: The good and the bad guys

Mike,

- 1) You wrote: « ...on-going supervision will also have to focus on qualitative aspects much more than quantitative ones, i.e. risks instead of ratios only. »

I think, that is exactly what we said. Maybe you can clarify your point?

- 2) You wrote: « This, of course, implies again a certain degree of technical excellence and capacity on the supervisor's side. It will also imply supervisory costs. And then, who will cover these costs? Will the registered MFIs contribute to the supervisor's budget? Or do you consider it as production of a public good, which the public budgets will have to finance? »

Yes, such an approach implies supervisory costs. If you look at the Ugandan case we were referring to, it is important to note that existing supervision on commercial banks follows a traditional approach, i.e. indicator based and largely relying on on-site inspections. I think there is no doubt that such an approach is definitely a costly one. Therefore, supervisory costs are already high. We believe with a risk-based approach focussing on licensing, policies and procedures and information disclosure overall supervisory costs will be reduced substantially over time, but we have no illusions regarding the high costs of initial investments in systems and human resources on both sides - supervisors and the supervised. Nevertheless, in sum risk-based supervision is less costly than purely quantitative, indicator-based supervision, not mentioning the other advantages of the former compared to the latter approach. We believe that this is especially true for microfinance, because on-site traditional supervision using on-site inspections will not only be costly but also not adequate for identifying risks in microfinance operations.

The question who covers these (lower) costs is another aspect. The answer is somewhere in the middle: Regulated microfinance operators reach significant scale, which justifies to charge them at least part of the costs for being supervised. But experience suggests (e.g. Bolivia as a very costly model) that full-cost recovery of supervision is certainly difficult (SBEF charges, as far as I know, 1% of total assets annually). Therefore, in Bolivia funding for the remaining part comes from the budget, which partly confirms the « public good » argument. By the way, that is what property rights theory tries to explain, isn't it?

In Uganda, the proposals developed address these issues. We are looking for a less-costly « small solution » of risk-based supervision for microfinance, which emphasises the licensing process (focus on management and ownership) and the ongoing analysis of operational procedures. In addition, a standard set of 10 - 12 financial indicators is suggested. This, we hope, will keep costs bearable for both, supervisors and the supervised, but I am not sure whether we can prevent that good guys turn bad...I believe that it is not only the regulators role to prevent moral hazard, I guess owners play an equally important role in this regard.

Best regards,

Alfred

From: Alfredo Ebentreich Aguilar [aebentreich@sbs.gob.pe]
Sent: Tuesday, 11. Juli 2000 16:56
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Regulation: The good and the bad guys

Mr. Fiebig,

there is no question that the theme of financial regulation to MFI is a recent one. Nobody should forget what Mr. Staschen wrote in his paper: there is a new-industry risk that does not only affect the MFIs but also the regulator which will ultimately supervise them if microfinance really wants to extend its outreach.

Regulation is not just looking at financial ratios, which is called off-site supervision, but also performing on-site inspections as often as it is possible. Obviously financial regulators are more used to supervising banks or finance

companies, but many financial regulators, as the peruvian Superintendencia de Banca y Seguros (SBS), are getting expertise to oversee such institutions. What happen to our bad guys in Perú's financial sector? Well, we close that institutions as soon as we notice there is something that does not work properly. We can also sanction them if they don't follow the prudential regulatory framework of the SBS. If we don't take such kind of actions, the effects will be worse.

But, regarding your last question, who pays the bill? The financial institutions contributes to the budget of the SBS with a tiny fraction of their total assets. This occurs because the SBS is an independent organism and if its budgets depends on local governments, that independence will be reduced. But, in case of a financial crises, there is a deposits insurance fund which can get some money from the government depending of the degree of the crises.

If you want some more information about peruvian regulatory framework or the experience of the EDPYMEs, feel free to contact me,

Best regards,
Alfredo Ebentreich
SBS

<p>From: Fiebig Michael [Fiebig@Bankakademie.de] Sent: Wednesday, 12. Juli 2000 10:44 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Regulation: The good and the bad guys</p>
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Alfred and Alfredo,

Thanks for your replies.

Maybe I haven't made myself clear on the first issue I tried to raise. Let me try again:

I absolutely support applying risk-based, primarily qualitatively oriented supervision. For MFIs as much as for commercial bank . And I fully support taking a VERY close look at governance, management, business policies and procedures, internal controls, MIS etc. It is especially important to be 100% convinced that the owners will actually watch closely what is being done in the financial institution as they are « in the driving seat » in good times as much as in bad times (Good owners may own bad institutions, but bad owners are unlikely to own good ones, to keep it simple).

All this already is a big challenge for many supervisors, who are more used to off-site-monitoring of ratios and doing quantitative financial audits once they are on-site in a financial institution. What I referred to was the challenge of ON-GOING risk-based supervision. That is, what happens AFTER the entry of an MFI to the marketplace. How do you control that systems and procedures are actually applied over time? How do you ensure that they are adjusted to changing marketplaces? How do you assess the appropriateness of cost and risk management capacities over time? This will most likely have to be done on-site in the institution on a regular basis, carried out by well-qualified microfinance/banking specialists. These will have check for example closely the independence and effectiveness of internal auditors. You can have the MFIs send you their updated manuals, MIS descriptions and staff lists, but this will not ensure that all of it is actually applied. This is what is going to be costly from the supervisors' side - but also needed!

I think that MFIs should contribute to covering these costs. The 1% rule in Bolivia and the cost-sharing in Peru seems to me to be a good answer to the fact that « safety of deposits » is a public good, but the « possibility of mobilising deposits from the public » is a private one.

From the MFIs side, transformation is quite costly as well. A GTZ study in Bolivia has estimated that establishing a Private Financial Fund costs approx. US\$ 700,000, excluding costs that were difficult to measure, such as training and staff development, opportunity costs of the formalisation process as well as the implicit costs of a mandatory reserve requirement. Quite a few dollars for the MFI to earn (or get sponsored by a donor)...

Just to be clear on this: While all this is costly, I believe establishing an appropriate regulatory and supervisory framework for MFIs will pay off in the end - in most countries. It will help massify sustainable microfinance and keep it on the scene once donor interest has moved on to other issues. But let's be clear about the substantial costs of all this.

An interesting benefit that seems to come out of the Ugandan Microfinance Bill: It looks as if modern supervisory techniques could spill over into the rather old-style commercial bank supervision!?! Would be good. Let's hope that the well-trained risk-oriented microfinance supervisors will not be assigned to other jobs than microfinance supervision quickly... (This has been the case in Bolivia).

Alfredo Ebentreich has provided some interesting insights from Peru. I have studied Uganda, Bolivia and Honduras (for a forthcoming publication on regulation and supervision under the FAO/GTZ initiative on Agricultural Finance). A few other regulatory projects have been discussed in various publications or documentation is forthcoming (Phillipines, Zambia, South Africa, Indonesia, Bangladesh) But what about all the other, not-so-well published cases of new microfinance laws? Any updates on experiences with microfinance SUPERVISION out there?

Best regards,
Michael.

➤ [... and Formalisation of MFIs \(5 mails\)](#)

<p>From: Betty Wilkinson [SMTP:seafan@pond.net] Sent: Mittwoch, 16. August 2000 07:28 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Re: Problems with formalisation of MF?</p>

Found this fascinating. Have often thought that the discussion tips too far in this direction, formalizing an industry that survived for a very long time in the informal sector, or organizations that operated quite well and sustainably at small sizes. What say the DFNers... is there room for it all? We and the Zambians thought so... they are tabling legislation right now that explicitly acknowledges traditional and small scale MF mechanisms as well as making room for those who want to grow big and go formal.

Betty Wilkinson

"Chris Watkins (NOTE NEW ADDRESS)" wrote:

From the ID21 newsletter:

Financial services for the poor: is commercialisation the answer?

contributor(s): Ana Marr - Overseas Development Institute, UK 07 July 2000

What is the best way for very poor people to borrow money? Can formal, regulated financial institutions reach the poorest and achieve financial sustainability? Research by the UK Overseas Development Institute in Bangladesh, Thailand, Peru, Colombia and Bolivia, casts doubt on the efficacy of formalisation - the transformation of an NGO-based microfinance institution into a formal bank - and suggests that it is far from the perfect solution. If financial sustainability succeeds at all, it may only do so at the cost of denying the poorest parts of society access to financial services.

<http://www.id21.org/static/1bam1.htm>

Bad is never good until worse happens.

- **Danish Proverb"**

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From: Muriithi Kagai [SMTP:mkaqai@yahoo.com]
Sent: Mittwoch, 16. August 2000 10:17
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Problems with formalisation of MF?

The debate on formalisation of micro finance services revolves along complex issues. What does commercialisation of an MFI mean? Does it mean converting an MFI into a bank? While the case for converting MFIs into banks is noble and perhaps done in pursuit of the need to create sustainable development structures, it is worthy pursuing what other options exist other than converting MFIs into banks. On the other hand, if the conversion of an MFI is seen as one crucial step towards achieving sustainability, we should also look at the other side of the coin. Why are MFIs not started as banks in the first place or why can banks not be influenced to serve the micro finance sector? Commercial banks are traditionally regulated by central monetary authorities which put certain key standards that should be fulfilled. Unfortunately most of these standards tend to direct banks away from investing in high risky, high cost MFI type of clients. This is an inherent conflict that is difficult to resolve. On the other hand, owners of commercial banks are investors who are not very much bothered on who buys their products but rather the returns they get.

Let me pursue another dimension as well. While MFIs are no doubt a crucial tool to fight poverty, they will not eliminating or substantially fight poverty because poverty is caused by many other factors. Unless those other factors are addressed at the same time with MFI type of interventions, we will continue to put higher demands for MFIs to solve a problem they cannot because other support linkages are not functioning to support MFI initiatives.

There may be a case for MFIs to be financially sustainable without necessary converting into commercial banks while recognising that the option of converting an MFI into a commercial bank is worthy pursuing (and has currently a good prima-facie case) if it is a natural evolution of an institution NOT a donor driven policy as a short cut to financial sustainability.

It would be crucial to explore more systematically the reasons why MFIs have not been successful in achieving sustainability which tends to point to a number of commonly talked about issues.

Ownership, Capacity and ability for MFIs to get into open markets like other commercial ventures to mobilise resources and other crucial support are issues that are not necessarily better handled through conversion into banks except that conversion is an easier way out but at an expensive COST. So we keep moving in a circle.

Regards,
Kagai

From: FSALTD@cs.com [SMTP:FSALTD@cs.com]
Sent: Samstag, 19. August 2000 09:53
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Problems with formalisation of MF?

Once you move away from the instant redistribution of funds as soon as the payments are on the table (a basic ROSCA) and as soon as there is some accumulation (moving towards an ASCA) then there is a verification problem (the case of lemons). The members/depositors cannot instantly verify if the system is working well enough to ensure sustainability. Formalisation or rather institutionalisation with rules and accounts is needed once the verification problem caused by increasing scale becomes unmanageable through traditional oral or back-of-the-notebook techniques. Therefore, the debate should not be on whether or not formalisation is good or bad, but on the process of institutionalisation of microfinance from simple ROSCA to ASCA and to more formal systems such as a credit union, FSA, NGO, Bank, etc. The MF industry has put too much emphasis on the graduation from NGO to regulated bank status (not a self-evident process by any means) and has not looked at the more general issue of degrees of formalisation/institutionalisation requirements resulting from higher transaction costs and scale for the entire spectrum.

Ahmad Jazayeri
FSA International

From: AFRACA [SMTP:afraca@users.AfricaOnline.Co.Ke]
Sent: Montag, 21. August 2000 23:47
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Problems with formalisation of Microfinance

If microfinance is to be sustainable it should be undertaken by institutions which are sustainable.

A number of Central Banks in Africa have recognised that it would be difficult for non regulated MFIs dependent on grants to transform into formal financial institutions. The paid up capital for registering a bank is usually high. No Central Bank will want every NGO which is involved in financing a few hundred micro entrepreneurs to dream of becoming a registered bank. Many NGOs have difficulty differentiating between promoting micro business and charity.

However many of these Central Banks have recognised the useful roles being played by financial NGOs in promoting micro financial intermediation and are putting in place legal and regulatory framework for MFIs which will enable them mobilize deposits and be subject to supervision. At the AFRACA workshop for Central Bank held in Harare last October, a number of the participating Central Banks reported the extent to which they have gone in lowering the conditions for the operation of MFIs.

It is interesting to note that in Nigeria it is the big commercial banks which are leading in microfinance, particularly in rural microfinance. It is also interesting that some of them have shown that their performance in rural finance contributes substantially to corporate profit. In other countries the commercial banks show their interest in wholesale relationship with established MFIs. This is infact the best arrangement for the sustainability of an MFI.

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From: FSALTD@cs.com [SMTP:FSALTD@cs.com]
Sent: Dienstag, 22. August 2000 12:41
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Problems with formalisation of Microfinance

There are socio-political and administrative obstacles facing the commercial banks related to the interest rate levels preventing them from covering the rural microfinance market. Even in a liberalised economy, a commercial bank could not charge their small rural borrowers 10 times the rates practiced by the same banks in urban areas. Socially, politically, and even administratively, such dualism would not be practical. But this may be what is needed to allow the banks to be in this market. I think it would be reasonable to say that for microfinance to be profitable in rural areas (the rate of interest must cover costs. inflation, loan loss reserves and return on equity), then the operating costs to assets (or just loans) ratio required can be as high as 18% - 20% (real). Adding this to inflation and to ROE comparable to what the banks get from their urban operations, then we are talking in the region of 4-5% per month (real) minimum. Unless the banks want to subsidize their rural operations, or accept a much lower return to equity, then it is unrealistic (and even unnecessary) to expect commercial banks to cover the microfinance market in a major way even if there are vast profitable markets out there. A similar point may apply to the externally funed NGOs who could not go beyond a certain level in their interest rates for socio-political reasons (again even in a liberalised economy, even if by law you are free to set interest rates at whatever level you like, you may be restricted otherwise). Formalisation of microfinance, therefore, should not just mean becoming a commercial bank (from NGO status) but should involve te institutionalisation process from very small informal operations to more structured user-owned systems and to sophisticated commercial operations. The regulation/support/supervision should assist the entire spectrum and not just the big guys. This is also an issue in the Uganda Financial Services Act to be approved by their parliament shortly. It covers the larger institutions and leaves the majority of Ugandans who do not belong to such institutions completely to their own resorts. They are

said to be unregulated but in fact they are ignored. No attempt is made in the law to provide some regulatory support to the organisations who operate under about USD 1500,000 of capital. There are many ASCAS with accumulated capital and substantial level of operations that have nowhere to go for guidance and the members are at a loss as to how to ensure that the system is being somehow supervised and that their money is safe. At FSA International we are promoting user-owned MFIs that receive a commercial license and we act in lieu of the regulator for quality control. The franchising/licensing approach should perhaps receive more attention in the discussions on formalisation and regulation.

Ahmad Jazayeri
FSA International

➤ **Agricultural development banks (6 mails)**

From: Dale W Adams [dwadams@burgoyne.com] Sent: Thursday, 6. Juli 2000 07:33 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Agricultural development banks

The latest issue of the journal <<Finance and Development>> (June 2000) has a provocative article in it: Hans Dieter Seibel, « Agricultural Development Banks, Close Them or Reform Them, » pp. 45-48.

Seibel notes that many traditional agricultural development banks (ADB) in Latin America and Africa have been closed or are moribund. He then briefly describes the successful reforms of ADBs in Indonesia—the Units portion of BRI—and BAAC in Thailand. (He might have also mentioned the successful reform of the ADB in Malaysia.) Largely based on these success stories in Asia, Seibel concludes that more ADBs might be successfully reformed and lists a framework for doing so.

Ten years ago I would have come out about the same place that Seibel does: arguing for more efforts to reform ADBs, in large part because of their potential to mobilize deposits in rural areas. Since then, however, I've mucked around in ADBs in Bangladesh, Uganda, Romania, Ecuador, Egypt, El Salvador, Peru, and Trinidad-Tobago and have become much more pessimistic about the chances of doing ADB reforms that persist. I've concluded that Indonesia and Thailand are special cases that can't be generalized to most other countries.

At least four factors undermine reforms of ADBs:

1. Bloated, yet well organized, staffs that oppose or subvert reforms.
2. Managers who are often political hacks with few banking skills and who stay on the job short periods of time. Weak leadership, combined with weak staffs, result in low-quality financial services. Most ADB clients are subsidy seekers or have no other banking options.
3. Boards of directors that are often controlled by ministries of agriculture. These ministries are interested in inputs, products, and poverty, not in operating an efficient and sustainable bank.
4. Government ownership of the these banks makes it nigh impossible to keep politics out of their operations. Unless ADBs capture most of their resources from depositors, they are vulnerable to political intrusions periodically that are life threatening.

In contrast to Seibel's recommendations for reform, I'd feel more comfortable if most ADBs were liquidated and closed as quickly as possible. Their rotten operations crowd out more useful and efficient forms of finance. Putting more resources into ADBs is simply feeding financial black holes.....jane.

From: Roberts, Richard (AGSM) [Richard.Roberts@fao.org] Sent: Friday, 7. Juli 2000 07:40 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Agricultural development banks

The four reasons Jane lists as mitigating against the effectiveness of reforms in ADBs are broadly true, but his conclusion, close the lot, is unrealistic.

There are still many countries, including some not far from where I sit now, where the political system is such that there is little alternative over the next few years to doing what can be done with the national ADB. To this extent Jane's

advice is a counsel of perfection, which needs to be trimmed to fit actual situations. This is why FAO, while not advocating the establishment of new ADBs, continues to work with those that are struggling along, some more successfully than others. This too is why we believe that Dieter Seibel's article is a useful tool in this process.

It is not just in Asia that there are some bright spots. The reforms carried out in recent years in the Land Bank in South Africa, with new products and new working arrangements, have opened up this bank to tens of thousands of small farmers. The performance of the new loan assets has been described as promising and improving, rather than fully satisfactory, but here again, there was little alternative.....

Richard Roberts
FAO, Rome

From: Dageng Liu [Dageng.Liu@wfp.org]
Sent: Friday, 7. Juli 2000 12:33
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Agricultural development banks

What would you otherwise propose if you do not have much choices as in the case of China ? Under the current policy framework you have to accept either the Agricultural Bank of China (ABC) or Rural Credit Cooperative (RCC), or you may get nothing out of it. Reforming them seems to be the most cost-effective solution.

Liu Dageng
WFP Beijing.

From: SRINIVASAN [gsns@vsnl.com]
Sent: Tuesday, 27. Juni 2000 07:56
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Agricultural development banks

The cure seems to be worse than the affliction. In most of these countries, the agriculture sector needs reforms first. Once agriculture becomes a commercial proposition and the cultivators carryout operations in the enterprise mode, Banks would finance them. As long as this does not happen, agriculture would find it difficult to access credit, necessitating ADBs or whatever other specialised institutions that are set up.

To be commercially viable, agriculture in developing countries should be free from unfair competition from the developed countries. In 1999 alone OECD countries subsidized farmers with \$361 billion which was more than 40% of farm incomes in these countries. Compared to government ownership of entire agriculture sector in the developed world, I find Govt ownership of ADBs in developing countries eminently acceptable.

Let us not analyse institutions and their relevance in parts; Let us examine the totality of their context before arguing for death sentence.

N.Srinivasan

From: dfitchett [dfitchett@email.msn.com]
Sent: Monday, 10. Juli 2000 15:29
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Agricultural development banks

Dale and Richard,

You seem to have taken polar positions on the question of the State-owned Agricultural Credit Institutions (SACIs, as Jacob calls them). There is of course an intermediate approach, between annihilation and resurrection, which would address a lot of your concerns. This is the privatization route. Under private sector management, many of the dysfunctional activities of the SACI may be performed quite efficiently without having to depend on government or external donor subsidies. Then the government could more carefully focus its limited money and human resources on performing the carefully defined and delimited «public good» functions which cannot be served by the privatized financial intermediary institutions.

The ad nauseum citation of BRI and BAAC is growing a bit thin. How about looking for successful privatized SACIs? While not an ag. bank, the old Bolivian DFI (development finance institution) known as BISA was privatized and now one of the biggest and best banks in Bolivia. Bank privatization is also a component in a number of donor-supported programs in the LDCs. How is the progress?

Del

From: J. Roth [SMTP:jr243@cam.ac.uk]
Sent: Montag, 10. Juli 2000 09:04
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Agricultural development banks (and inductive chickens)

A horse which has been often driven along a certain road resists the attempt to drive him in a different direction. Domestic animals expect food when they see the person who feeds them. We know that all these rather crude expectations of uniformity are liable to be misleading. The man who has fed the chicken every day throughout its life at last wrings its neck instead, showing that more refined views as to the uniformity of nature would have been useful to the chicken. The Problems of Philosophy, Bertrand Russell, 1912 While my own limited knowledge of the performance of ADBs is similar to Dale's (dismal performance for the reasons he has given). I am a bit more reluctant to draw the conclusion that he has drawn. The fact is that institutional reform is possible (cf. BRI, BAAC as mentioned). There is no iron law which tells us that institutions cannot develop defenses against against the threats listed. Given that an expensive institutional infrastructure exists surely we should take each case for reform or closure on merit? Instead of throwing in the towel, I think time would be well spent developing innovative institutional defenses and learning from existing ones.

➤ **Information systems and Microfinance (4 mails)**

From: Normand Arsenault [normand.arsenault@sympatico.ca]
Sent: Tuesday, 4. Juli 2000 18:41
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Information Systems & Microfinance

Dear DFNs

In response to Warren Wright's, Olaf Kula's and Andrew Mainhart's excellent comments on Information Systems & Microfinance, I would like to add the following note:

THE KEY TO INFORMATION SYSTEMS : INFORMATION

According to the CHAOS research conducted by the Standish Group International, Inc. (see: <http://standishgroup.com/visitor/chaos.htm>), the three major reasons that a project software will succeed are:

- **User involvement;**
- **Executive management support;**
- **A clear statement of requirements.**

There are other success criteria, but with these three elements in place, the chances of success are much greater. Without them, chance of failure increases dramatically. Software projects do not usually fail for technology reasons. Some MFIs mistakenly view their Information System as a technical issue. The key to information systems is « Information ». And information is one of the central problems of microfinance.

It has been said that there are three categories of information that have direct bearing on the success or failure of an enterprise:

- **Information that we know we know (perhaps 25% of the total).**
- **Information that we know we don't know (another 25%).**
- **Information that we don't know we don't know (potentially 50% of the whole)!**

Users will frequently know what information they need when they see it.

To put it another way, consider this question:

« What are the five strategic questions which, if I could answer factually, would dramatically influence the direction of the microfinance institution? » Answering these questions might well define the purpose of implementing an Information System. The performance of the business should be improved in what area? What are the indicators that will be used? What are the priorities and perspectives of the business?

Clear information requirements are to be pinned down by people who can understand the business processes, the business strategy and the organization of the microfinance institution and convert such knowledge into a functioning application. The management of the MFI should be driven by the business needs instead of technology. Most often the technologists assume control of the project, and the focus becomes putting the technology in place. This may explain the lack of management support. When the project is driven by business needs, much of the time and energy come from the management.

While you may be able to buy the technology components, you can't just buy their integration with the business strategy, the organization and the culture. Successful implementation of an Information System requires, among other things, a significant investment of time and energy on the part of many, maybe most, of those who will be its users, to ensure that the end result meets their needs. It is a tedious, lengthy, and frequently contentious process:

- **Many intense discussions to reach agreement on purpose, business rules, priorities, data retention, and other key issues;**
- **Significant time commitments from key leaders in the enterprise and politically sensitive information revealed by reporting from the Information Systems.**

Users include employees and management of the microfinance institution but also clients, board members, donors, investors, government ministries and agencies, country's supervisory agency or regulator, etc.

Users' needs change as they gain knowledge about their business and as they think of more creative ways to use the Information System. Successful businesses adapt to change, and as they change, the systems, which record business activity, change to capture the most relevant data. It is therefore puzzling how many Information System projects are undertaken with the notion that, once the system is in place and running, the project is completed. It should be recognized that the IS will evolve over time.

I agree that off-the-shelf software should be used for the accounting system and the basic banking operations. However, I believe portfolio tracking and financial monitoring systems need to be custom developed locally to reflect the specific operating procedures, workflow, products, and structure of the MFI network which strongly vary from one institution to another and even in time. Vendors of packages do not usually share their source code so that the microfinance institutions will depend on them for updating their software. This can be expensive and arduous.

The only successful way for an off-the-shelf implementation to be successful is to decide at the outset that you are going to reengineer your business to fit the limitations of the software package. These off-the-shelf software usually imply a specific method of doing business with a corresponding set of capabilities.

Finally I would like to quote the excellent CGAP « Handbook for Management Information Systems for Microfinance » by Chuck Waterfield and Nick Ramsing (p. 6):

« Management can greatly improve the prospects of developing a good information system through a willingness to evaluate and change the way the institution works. Information systems can perform only as well as the institutions they model. If policies, procedures, organigrams, job descriptions, workflows, and the like haven't been properly established, no MIS will function well. So developing and implementing a new MIS, or reworking an existing one, may affect every part of an institution-and generally should, if the process is to be successful. »

Normand Arsenault c.a.
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From: Andrew Mainhart [SMTP:andrew.mainhart@roku.com]
Sent: Dienstag, 13. Juni 2000 17:43
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Information Systems & Microfinance

Warren Wright's question does beg an answer and Olaf Kula's comments beg my reply....

As Olaf Kula mentions, everyone even thinking about Information Systems (IS) for Microfinance should read the CGAP „Handbook for Management Information Systems for Microfinance“ by Chuck Waterfield and Nick Ramsing (I believe it can be ordered from PACT). The DfID Springfield Report on MIS in Microfinance (Mark Havers & David Ferrand) and the USAID MBP Framework for evaluating Information Systems in Microfinance (Andrew Mainhart - <http://www.mip.org/pubs/MBP/MIS%20Framework-DRAFT.htm>) are must reads. Also the SEEP organization has extensive background material on the development of 5 Information Systems for microfinance based on 5 Citicorp grants. In addition to these microfinance specific documents, one should also endeavor to read about the subject of information systems in more general books and

articles that can be found in most (even developing country) bookstores or on the Net. I've spent the past two years specifically looking at the problem of Information Systems in microfinance. In fact, my entire career has centered on software applications and development of good information systems. So, in part I agree with Olaf. It is true that „after sales service, flexibility in the system to accomodate new financial products and accessibility, and limits to accessibility for the various levels of users, (from credit officers, and accounting and finance staff to board members), is the most important criteria“ for IS. For the most part, I also agree with his delineation of the different types of systems currently found in MFIs.

However, I do not agree with his conclusions. There are several integrated off-the-shelf packages available in most regions on a commercial basis. This „build your own“ mentality generally leads to huge costs and effort and rarely have I seen it end up in outright success. The problem is that most institutions do not have the knowledge or resources to build a system or maintain one over the long-run. In addition, finding skilled resources in most developing countries is an enormous issue. Its hard enough hiring Credit Officers, let alone good software programmers. There seems to be a rather large assumption that good software is easy and cheap to build and support ad infinitum. I'm here to say, that is a totally wrong assumption. Building high-quality computer software requires an enormous amount of effort, skill, tenacity, attention to detail, and MONEY!

There can be a multitude of products in microfinance if:

- 1) We become less stubborn about certain requirements.
- 2) We define some standards of operation.
- 3) We understand the COST of building & buying software (this includes DONORS).
- 4) We learn to understand and improve our business before implementing software.
- 5) We learn to work with vendors amicably and reasonably.

Lastly, I agree with Olaf that Donors should pay more attention to the process of Software Development. I find it a bit appalling, in fact, that we go around the world shouting the praises of „Sustainability“ and financial/accounting soundness, and in the next breath say in one paragraph or one glib phrase „implement a MIS“. It isn't that simple—in fact it is that hard. If I boil Microfinance or financial services of any kind down to it's most basic level it is nothing more than INFORMATION & RELATIONSHIPS. MFIs manage information. Without it they fail; without it there is no SUSTAINABILITY. We need to train the managers of MFIs on the Software Development Process—how do they decide what they need (& don't need) and how do they take those requirements and ensure they get a final product that meets those needs?

PS: Trade shows are a great idea and have been done—though in limited fashion. In fact, one was put on in Baltimore last October by SEEP in which 8 vendors presented and displayed their wares. I believe one just took place somewhere in Eastern Europe as well with some great success I hear. (Most of these vendors do absorb the costs for their

presence, provided the number of participants is high enough. Obviously, there is a cost/benefit analysis that they must do as well.)

PPS: Notice I use the term Information Systems or IS as much as possible, NOT MIS or Management Information Systems. Unfortunately, most MFIs are not ready for complex MIS, they require basic information and therefore basic Information Systems. Accounting and Loan tracking software is basic software, not management specific.

Andrew Mainhart
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From: Olaf Kula [[SMTP:okglobal@bellsouth.net](mailto:okglobal@bellsouth.net)]
Sent: Freitag, 9. Juni 2000 18:17
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: IT system evaluation

Warren Wright opens an interesting topic with his request for criteria to evaluate MFI MISs. I hope a number of DFNers respond with criteria. I would also suggest the very useful if a little dated publication that Chuck Waterfield and I believe Nick Rofe and others did for CGAP on MIS systems. Since I only have an earlier draft, I hesitate to give the full citation.

In my own experience after sales service, flexibility in the system to accomodate new financial products and accessibility, and limits to accessibility for the various levels of users, (from credit officers, and accounting and finance staff to board members), is the most important criteria in a combined financial product tracking (not just loans)-accounting software. To many MFIs cost is a big concern--- particularly the cost of obtaining after-sales service and assistance in modifying the system to accomodate changes in financial products.

It is also helpful to delineate what the options out there are for MFIs.

I have come across the following options. I will avoid using names of different providers here to avoid recommending the mediocre or unjustifiably criticising the very good programs due to my too limited but negative experience with them.

1. Single product off the shelf that combines financial product with accounting system tracking. A number of MIS systems designed for MFI's, use their own accounting/finance software.
2. Two product off the shelf financial product tracking, with a separate and standardized off the shelf accounting software. This links a MFI MIS software for a relatively limited market to a major and standardized small business accounting package.
3. Custom developed financial product tracking with a standardized off the shelf accounting package.
4. Fully customized financial product tracking-accounting package.

I strongly favor using an off the shelf standardized accounting software, and a custom and locally developed financial product tracking system. The after-sales service needs, and modification for new products argue strongly against the existing off the shelf MIS systems for MFIs. While locally developed custom systems (best obtained from a software developer who has developed similar systems for other financial institutions) have as many problems as the off the shelf competitor, after sales service is generally much better with the locally developed system.

Arguments in favor of the off the shelf system mostly fall in the 'it is better not to re-invent the wheel' category. This metaphor is apt, but it does not defend the purchase of off the shelf financial product tracking software for two reasons. The first is that while all wheels are built on the same principal, (360 degrees, a hub linked to a rim with spokes that absorb shock and control tension) most wheels differ according to the size, strength, longevity and use needs of the user. Second, most wheels are built and serviced locally because given the wide divergence of client need, there are few economies of scale in standardized wheel building. Ditto for MIS financial product tracking software.

We need go no farther for evidence than the majority of commercial banks, in developing and developed countries. I can think of none who use an off the shelf product for their financial product tracking. Most either develop their software in house, or hire a local software developer who can quickly fix something when it does not work.

Donor interest in supporting MFI MIS systems would have a more positive impact on the MFI and on local economic development by developing a wheel building guide for MIS software developers rather than promoting software whose owners proprietary interests are in conflict with the clients need to modify the product as often as the market demands.

In the absence of a design tool or guide, perhaps a donor interested in MISs could organize a trade show, inviting the off the shelf and the customized providers to promote their product in a competitive environment. One would think that the vendors should be willing to absorb much of the cost of organizing such a trade fair.

Excuse me Warren for using your request to try to open some debate on this very important subject. I look forward to the results of your work.

Olaf Kula

From: Warren Wright [SMTP:warrenwright@hotmail.com]
Sent: Mittwoch, 7. Juni 2000 17:18
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: IT system evaluation

Dear Microfinance Professionals,

I am writing an independent study evaluating microfinance information technology(IT) systems. I am a graduate student at American University, Washington DC in the MBA program and the International Development Management program.

I believe there should be a comprehensive system that combines loan tracking and accounting software into an integrated whole. My first task is to identify the necessary criteria to evaluate microfinance institution software. Any information identifying criteria would be greatly appreciated.

My second task will be to evaluate software based on the developed criteria. I am searching for programs to evaluate. Confidentiality will be provided to participants and contributors as requested. Results will be shared with participants. Thanks for your consideration.
WarrenWright

➤ [Over-indebtedness \(6 mails\)](#)

From: imatin@worldbank.org [SMTP:imatin@worldbank.org]
Sent: Dienstag, 22. August 2000 23:45
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Over Indebtedness

I have seen a lot of messages on this list criticizing the 'microdebt' industry to be at times over indebting clients. I am interested in getting a handle on this issue in the context of MFI competition. What does this actually mean conceptually and how would one go about measuring the incidence and/or severity of this phenomenon? How does one attribute this to actual debt taking vs shocks and lack of good insurance instruments? In general, how can we separate out the many fold forces that lead up to 'over indebtedness'? How does this relate to debt structure, its rigidities and institutional policies?

Any thoughts?

IM

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From: Olaf Kula [[SMTP:okglobal@bellsouth.net](mailto:okglobal@bellsouth.net)]
Sent: Donnerstag, 24. August 2000 18:53
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Over Indebtedness

Many of us wish we really had the panaceaic response for IM's question.

Lots of MFIs are now tackling this, or rather parts of this. Credit reporting and insurance (to separate shocks from instruments) are two means being used. In lending to the poorest credit reporting often is not effective because the bulk of a borrowers indebtedness may come from completely informal lenders.

I would like to comment on the issue of over-indebtedness and the financial instruments. I would further like to hook the formalisation is always good proponents in summarizing some research done in Ghana.

I worked with an historian in Ghana doing a study of enforcement of loan contracts in the informal sector as an input into designing loan products for CARE.

The very interesting finding was that as rules procedures and contract law became more formalized so did the level of defaults which soon after led to a decrease in the level of financial services available.

Prior to formalisation of loan contracts, the informal sector used a "circle of witnesses" who would publicly state that there were no outstanding liens on the borrowers land or other assets and what his/her known obligations were. This circle of witnesses was essential in the use of mortgaging assets to secure a loan in an informal process called pledges. The circle was made up of 10-20 members of the community. The circle served as a title search and an assessment of repayment capacity.

With the formalization of loan contracts and the appearance of rural and the agricultural banks, a borrower only was required to present two witnesses to the signature of the contract. This made it easy to hide ones indebtedness and the degree to which ones assets were mortgaged. The result, higher defaults, banks unable to seize assets already informally mortgaged to another, and very rapidly a decrease in the level of lending.

CARE in Ghana recently introduced support to financial institutions that reintroduce the pledge and circle of witnesses in a 'micropledge loan product'. It is too early to assess, but it is one attempt to improve upon the instruments used to reduce over or double indebtedness, Looking forward to more thoughts on this important question.

Olaf
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Sent: Freitag, 25. August 2000 09:29
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Over Indebtedness

I enjoyed reading the comments on the issue of over indebtedness.

If we look at the real world situation of poor households, they employ a number of strategies to cope with shocks, risks

and uncertainty and to smooth their disposable income and consumption over time. Borrowing (debt), saving and insuring behavior in kind, money and social relations are complementary strategies in order to get by and ahead. Taking into account this complexity in household strategies, over indebtedness could be conceptualized as a disequilibrium in this situation in the sense that there are (too many) claims from family, friends, moneylenders, micro finance programs that the household in the end cannot comply with. Not only do(es) the claim(s) surpass the household's capacity to repay but also the very existence of such a situation (i.e. a household receiving from several sources too much credit) has probably severed the complex and often fragile system that surround household's strategies with respect to saving, borrowing and insuring.

The solution appears to be very complex too. There are too many information asymmetries between the different actors related to a certain household's saving/borrowing/insuring strategies. Even not taking into account the range of 'informal' actors and mechanisms, there is a lack of information exchange between formal financial intermediaries. The evidence presented by Olaf seems interesting with respect to reducing the information asymmetries. Our impressions from Central American experiences suggest that an intensive articulation with local communities is essential. Local credit committees and existing clients often are able to help sketching the situation of potential clients thereby helping the MFP to lend the right amounts of money under the right conditions. However, this appears to be only part of the problem.

The issue merits more attention. Perhaps some of the papers written by AIMS would help us to better conceptualize the issues at stake.

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From: FSALTD@cs.com [[SMTP:FSALTD@cs.com](mailto:FSALTD@cs.com)]
Sent: Donnerstag, 24. August 2000 23:39
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Over Indebtedness

Microcredit (as opposed to microfinance) has basically disposed of two fundamental measures of debt capacity namely the voluntary savings record and the collateral. This is why customers can be borrowing from six different MFIs at the same time, use one loan to pay another, and end up in severe over-indebtedness (recent research from Uganda). The problem is largely in the methodology itself and the over-abundance of donor funds to support microcredit programmes and should not be blamed on external shocks or lack of insurance instruments.

Ahmad Jazayeri
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From: Didier Thys [[SMTP:dthys@freefromhunger.org](mailto:dthys@freefromhunger.org)]
Sent: Freitag, 25. August 2000 21:14
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Over Indebtedness

Ahmad raises two important operational issues, but I'm not sure they get at what IMRAN is trying to nail down.

1. Shouldn't we assume that most people will borrow from multiple sources at any given time for various purposes? Maybe not, but that would be an interesting item to raise in assessing over indebtedness. What should be the value of a household's outstanding liabilities at any given time and is it bad to have it sourced through multiple institutions or individuals?
2. Donor funding contributing to the use of one loan to pay off another is only an issue where donor-funded institutions have chosen to concentrate in the same areas. It is an important issue, but maybe it relates more to Chambers' traditional critique of roadside development than to anything else. It does not get at the fundamental question of how one should measure "over indebtedness".

Is there some Cook ratio for poor households out there? How do they do their own calculus on these things?
didier

From: Ernelson@worldbank.org [SMTP:Ernelson@worldbank.org]
Sent: Dienstag, 29. August 2000 05:08
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: over indebtedness

In case anyone missed one of the pearls amid the dross this subject has engendered on DFN, Jos Vaessen has made an important conceptual contribution to microfinance for the poor: placing the definition of "over-indebtedness" within the context of the entire panoply of coping (and advancement) techniques of the poor.

Many of us now oppose willy-nilly pushes to increase the indebtedness of the poor (thank you, Jane) in the name of productive micro-credit. Our DFN discussions of a couple of years back looked at all the financial needs of the poor, being (roughly in descending order of priority, with no. 3 being a tie in empirical work) (#1) emergency liquidity (to avert disaster or profit from windfall opportunities, annualized interest rate be damned because it's only for hours or days), (#2) expansion and diversification of income/consumption sources, (#3a) safe savings or at least money holding, (#3b) transfers, and (#4, last and lowest among self-identified priorities) increasing household indebtedness or so-called "credit".

Vaessen gives an articulate summary of the issues involved in determining "over-indebtedness" in this broader context and concludes "The issue merits more attention." I concur and believe a good thesis topic is begging for attention therein. Not to mention an improvement of microfinance institutions offering the services discussed.

Eric Nelson

➤ [Micro-insurance through MFIs \(1 mail\)](#)

From: J. Roth [SMTP:jr243@cam.ac.uk]
Sent: Freitag, 25. August 2000 11:40
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Micro insurance through MFIs

Many MFIs seem to be considering increasing their product range to include insurance. They are faced with a choice of either starting their own insurance scheme or where possible acting as agents for another scheme. Set out below is a list of the costs of benefits of these two approaches. What other experiences have people had? What's missing from list?

1.1 SELLING INSURANCE DIRECTLY

1.1.1 Benefits

A local MFI is often very close to its market. Typically lenders deal with groups directly and come to have a textured understanding of the socio-economics of local households. This can allow them to design products that match their clients socio-economic profiles. In essence MFIs that have a history of dealing with clients have an informational advantage over socially and geographically distant insurers. So, for example, a distant insurer may sell insurance that covers nuclear family members. While this may be appropriate for city dwellers, rural clients may not live in nuclear type households and prefer a wider cover for example for an extended family.

Clients need to feel assured that when they have a legitimate claim their insurer will pay. If an MFI has developed a longstanding and positive relationship with client through its savings and/or credit business, such a relationship will inspire confidence in a new insurance product. In many LDCs insurers are not willing to provide insurance to MFI clients or any low-income groups. By providing insurance MFIs can protect their loan portfolio against some of the common causes of borrower default viz. loss of income due to involuntary retrenchment, sickness, death or loss of/damage to property.

An MFI may be able to use its intimate knowledge of its clients, to determine their mortality rates, sickness rates etc. in order to set premiums reducing the need for other statistics. Whether the MFI sells insurance directly or as

agents, the distribution channel is already in place. The common MFI practice of group lending, facilitates the sale insurance to groups thus further lowering transaction costs.

Finally, again whether MFI sells insurance directly or as agents, the existence of risk reducing insurance may allow micro and small entrepreneurs to engage in risky and more rewarding activities.

1.1.2 Costs

Banks in the USA and Canada cannot sell their own insurance policies. Regulators felt that combining the two functions would create a situation in which the managers of banks or insurance companies would have the ability to sustain one side of the business if the other side was performing badly. This could place savings or insurance benefits at risks.

In LDCs with often-weak regulation and regulators, extending an MFIs portfolio to include insurance could prove catastrophic. Without strong regulation or internal controls an insurance fund will prove very tempting to an MFI manager who wishes to bolster his or her under performing loan portfolio. Such behaviour could place both saver's deposits and insurance benefits at risk.

It is very difficult to run an insurance scheme. The skills required to run such a scheme are very different to those required for a lending and/or deposit taking institution. The skills involved in assessing credit worthiness (e.g. project appraisal, previous credit history assessment) are very different from those required to design and manage insurance schemes (e.g. setting premiums, forecasting losses, investing the fund safely).

Scale and client diversification are crucial in insurance schemes to protect against co-variant risk (the risk that an event will occur, for example a fire in a wooden shanty town, that will affect lots of policy holder at the same time). Not all MFIs have the client numbers of Bangladeshi MFIs. In Africa in particular MFIs often have only a few hundred members all located in an isolated, sparsely populated area.

Whether the MFI sells insurance directly or as agents, access to insurance may increase moral hazard. Moral hazard occurs in situations where economic agents do not bear the full consequences or, equivalently, do not enjoy the full benefits of their actions due to uncertainty and incomplete or restricted contracts. In respect of insurance, moral hazard poses a number of problems. Firstly there is the problem that once something is insured the owner is likely to be less vigilant in his or her care of the insured object, safe in the knowledge that should something happen „insurance will pay“. So for example a small scale cattle farmer will pay less attention to husbandry safe in the knowledge that should one of their cattle die that was bought on credit, the insurer will pay them out and they will be able to repay the loan. Insurance may also establish perverse incentives for MFI loan officers to be less careful in their appraisal of credit worthiness, if they know that insurance will repay them if their clients do not.

By developing an insurance scheme new opportunities for total institutional failure arise. If the insurance side of the business is not separate from the savings and credit side massive insurance losses may cause insolvency in an otherwise successful savings and credit operation. Even if the two businesses are legally and financially separate, clients may equate the two and lose confidence in the savings and credit business.

1.2 ACTING AS AGENTS FOR AN INSURER

1.2.1 Benefits

An additional product is offered to clients at far less risk to the MFI that if it sold the product directly.

The MFI will earn commission income for selling the products

The MFI gets protection against borrower income loss at far less risk to itself than if it sold the product directly.

Unlike designing and managing a insurance scheme from scratch, acting as an agent for another insurer is in comparison an infinitely simpler task..

As described in section 1.1.1 above with an agency relationship both the insurer and the MFI benefit from existing distribution channels and whether MFI sells insurance directly or as agents, the existence of risk reducing insurance may allow micro and small entrepreneurs to adopt riskier and more profitable activities.

1.2.2 Costs

In the context of actually existing MFIs, a close relationship typically exists between the MFI and its clients. Clients may come to see MFI as endorsing the insurance product or in the worst case scenarios may not realise that the insurance product is actually provided by a different institution. This problem will be compounded if

commission income for selling policies is significant and MFI staff are incentivised to sell as many policies as possible. This could introduce problems of conflicting interests when claims are made and disputes arise.

As described in section 1.1.2 above, whether sold directly or as an agent, the introduction of insurance may pose moral hazard problems for the MFI.

Finally, the provision of insurance may reduce the demand for the MFIs savings and insurance products. One of the central reasons for the engagement of the poor with MFIs, is to get access to savings and insurance products. Savings, credit and insurance are all ways of reducing risk. The existence of insurance may reduce the demand for MFI savings and credit products.

Jimmy Roth
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