

ANNEXES

To the Devfinance quarterly Review

October 2002 – January 2003

General information

➤ Planet Rating in Bosnia and Herzegovina (1 mail)

From: J. D. Von Pischke [mailto:jdvp@erols.com]
Sent: Montag, 2. September 2002 14:08
Subject: Devfinance: Prof. Bouman has passed away

Dear all,

Planet Rating updated Prizma's rating report (Bosnia and Herzegovina): Prizma gets a G4* with the composite rating of (aabacb), thereby confirming a strong positive trend.

The report is now on line : you can either download the [executive summary](#) or the [full report](#). If you wish to receive it by email, please write to rating@planetfinance.org. You will find below some information on BiH and Prizma.

----- Meet us at the Microcredit Summit+ 5, in New York-----

- **Alice Nègre, Director, "New Initiatives in Microfinance Ratings", on Monday 11 at 5:15pm**
- * **Karen Maguire, Rating Supervisor, "External Audit for MFIs" on Tuesday 12, at 11:15 am.**
- * **Associated Session on Tuesday, at 1:30 pm, "Risks and Challenges of Rating in Microfinance: Lessons Learnt".**

Microfinance in Bosnia and Herzegovina

Seven years after the end of the conflict, the BiH economy is still relying on foreign support. Unemployment remains high at around 40% while the state-owned enterprises and banks are undergoing privatization and restructuring. The main growth sectors are services and light industry with small and medium enterprises leading the way.

The microfinance market is growing more competitive, both among MFIs and more recently with banks for consumer and housing loans. This increased competition led to takeovers/mergers among MFIs and increased sophistication in the sector. A list of MFIs is provided in our rating report.

The bulk of funds for the microfinance sector has been channeled through the World Bank financed Local Initiatives Project (LIP), the goal of which is to support and enable the development of financially strong microcredit programs. The LIP initially provided financing and technical assistance to 17 NGO microcredit service providers in both entities. A total of 21.7 million USD was allocated under Phase I of this project (1996-2000) and under Phase II (2001-2003) an estimated 18 million USD will be available for loans and technical assistance to participating MCOs. With support from the World Bank, the MFC and CGAP, the microfinance sector in BiH is highly professional, with most institutions adopting best practices.

After a mid-term review of the Project in 1998, the LIDs carried out a performance assessment of the institutions and decided to continue to finance only nine organizations. Institutions currently supported by LIP include in the Federation: LOK, Sunrise, EKI, MI-BOSPO, BOSVITA, and Partner; and in the RS: Benefit, Mikrofin and Sinergija. A reduction in the number of MCOs funded by this second phase spurred consolidation within the microfinance sector through takeovers/mergers. This consolidation trend is likely to continue.

In addition to World Bank funds, bilateral aid for microfinance has come predominantly from US sources (USAID, USDA, and BPRM), DFID (England), SIDA (Sweden), CIDA (Canada), as well as the Austrian, Italian, Dutch, Spanish, Swiss and Japanese Governments.

Prizma

Prizma has identified clearly its target client for each product. The core Group Enterprise Loan product meets the needs of economically active poor and low-income women. Urban state employees with low salaries and the unemployed may benefit from the Basic Needs Loan. Individual Loan and Housing Loan clientele have greater financial resources than the other target groups or have successfully graduated from other loan products. Prizma closely monitors its target with impact and market assessments.

Despite remarkable efforts to anticipate and manage its credit activities, Prizma experienced unanticipated market reactions in 2001. Portfolio growth has varied from the projections both in total and by product. New products have proven an immediate success and led to a complete restructuring of the portfolio since 2001. For these new products, Prizma has made several innovations: collateral requirements in lieu of solidarity groups, three-year maximum maturity instead of 12 months, and new loan purposes to include consumption and housing in addition to income generation. The impact of these new products, which will account for an increasing part of portfolio, will be difficult to predict despite the care taken in developing and piloting the products. Although the PAR remains at low levels, its recent increase, especially for the Basic Needs Loan, should be and is closely monitored by Prizma.

Prizma effectively monitors most risks, especially with the recent addition of an Internal Audit department now testing a very comprehensive set of audit tools. Most external risks are linked to the unpredictable legal environment, which could have impact both on Prizma's clients (unregistered businesses may have to register and pay taxes) and on Prizma itself (current restrictions on allowable activities).

Since inception, Prizma has received funds mainly from UNHCR and BPRM and to a lesser extent UMCOR and CGAP. The institution has an ambitious financing program relying on loans, the first being a commercial loan from CORDAID.

Prizma is an efficient institution. Since 2000, productivity has continued to increase and should compensate for the increase in headquarter costs. Productivity improvements have increased efficiency, but Prizma's strategy, resulting in a decrease in the average loan at disbursement, has limited potential efficiency gains. The expense ratio, stable over time, masks the underlying dynamics of increased productivity coincident with expense increases, notably due to a 69% increase in staff expense (legal requirement to pay social benefits and taxes upon localization in October 2001). New MIS and streamlining efforts now in place should further improve efficiency.

Prizma has shown an unusual trend in profitability with an impressive increase through September 2001 and a decline in profitability thereafter. This decrease is mainly due to the increase in taxes and social benefits with localization, the launching of new products with lower interest rates and a strategic decision to move even further down-market. Certain products are too new to prove their profitability. Given that these new loans will represent an increasing part of the outstanding portfolio, Prizma carefully monitors their effect on profitability. Return on Equity is 5.6% in Dec 2001 before adjustments and (1.5)% after adjustments, including special adjustments for local personnel taxes. This ROE ratio decreases to 3.3% in June 2002 (annualized unadjusted figure), but after adjustments shows an increase from a negative figure in 2001 to a positive 0.8% in June 2002.

Prizma's cost control orientation has led to the pilot of "ABC" (Activity Based Costing). This approach will serve to better identify costly and time-consuming aspects of operations so as to make work processes more efficient and profitable. In 2002, expansion to new markets should first increase overall costs, although in a controlled manner, and then generate new revenue to help defray the fixed costs of the headquarters. Revenues could grow with more consistent and sophisticated liquidity management. In the medium term, all these organizational changes should lead to an increase in the already positive profitability.

Publications

➤ [How to do deposit mobilization \(1 mail\)](#)

From: Dale W. Adams [mailto:dwadams@burgoyne.com] Sent: Donnerstag, 30. Januar 2003 01:04 Subject: Devfinance: Doing deposit mobilization

A new book by the WOCCU folks on the nuts and bolts of deposit mobilization is a good read.

Brian Branch and Janette Klaehn (eds) <<Striking the Balance in Microfinance: A Practical Guide to Mobilizing Savings, Lessons from Credit Unions in Latin America,>> Washington, D.C.: Pact Publications, 2002. Email for ordering book = books@pacthg.org. Website = www.pactpublications.org. WOCCU website = www.wocccu.org.

The book shows the extent to which the philosophy of credit union leadership has changed over the past 20 years from borrower dominated concerns to increasing attention to the well-being and interests of cooperative members who wish to be savers. Three cheers for the change!

The book is especially strong in describing how to boost deposit mobilization and also detailing how this will strengthen financial cooperatives. A few of the topics covered include the environmental conditions needed to mobilize deposits, designing and providing savings products, setting interest rates, marketing deposit services, and calculating the costs of deposit mobilization. Case studies from Ecuador and Nicaragua are also presented to illustrate successful deposit mobilization efforts.

Two classes of people should read this book carefully: First, the book is a must for those leaders in the credit union movement in low-income countries who want to build stronger financial cooperatives with substantially more outreach. Second, all donor employees who attempt to design a credit union project should be required to sign an affidavit that they have carefully read this book and swear their project will not damage the willingness and ability of the associated credit unions to mobilize more deposits.

The only flaw I see in the book is that it wasn't published and widely read 30 years ago.....jane.

➤ **The Micro Finance Revolution, volume 2 – recommendation by R. Rosenberg (1 mail)**

From: Rosenberg@worldbank.org [mailto:Rosenberg@worldbank.org] Sent: Mittwoch, 6. November 2002 19:36 Subject: Devfinance: The Microfinance Revolution, volume 2: Lessons from Indonesia
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I have FINALLY found time to read the second volume of Dr. Marguerite Robinson's book, The Microfinance Revolution. Like Dale Adams, who reviewed it on this listserve a while ago, I would recommend this volume to anyone interested in microfinance or development finance more generally. There are several chapters, noted below, that would appear especially useful for practitioners.

Robinson has wide experience with microfinance worldwide, but Indonesian microfinance is piece of it she knows most intimately. Most of us involved in microfinance have heard about the performance of the Unit Desa system of Bank Rakyat Indonesia (BRI). What is less well known, at least for those who haven't yet seen Dirk Steinwand's The Alchemy of Microfinance, is that Indonesian microfinance is over a century old, and that besides BRI there is a rich panorama of other microfinance providers, some of them very large, and some of the smaller ones very interesting—particularly the private Bank Dagang Bali, which was founded by a poor couple as a way to extend their moneylending business, and has been serving rich and poor customers under the same roof for three decades now. In 1998 Indonesian MFIs were reaching well over 20 million clients.

Robinson portrays Indonesian microfinance, along with its political, economic, and cultural environment, in luxuriant detail. There are dozens of policy lessons, with plenty of real-life examples of rural and microfinance disasters. The most operationally useful part of the volume lies in three chapters that give an extraordinary step-by-step account of the challenges, decisions, and discoveries that went into building the modern Unit Desa System, a strongly profitable intermediary that had 2.7 million borrowers by 2000 with an average outstanding loan size of \$300, and 25.8 million savers with an average account size of \$77. Chapters 9 and 10 examine the development of the loan and savings products, while Chapter 11 looks at the key organizational issues that were dealt with along the way. I have never before seen such a detailed and insightful dissection of the building of a great MFI. These chapters should be particularly interesting to microfinance managers. BRI's "model" is not a template for copying, but other MFIs face many of the same challenges, and will probably find helpful ideas and perspectives in the BRI story—especially its disciplined, systematic approach to product design and roll-out. Commercial bankers considering microfinance will find a lot to think about in the chapter on organizational issues, because yoking microfinance to a commercial bank is a process that has proved to have its share of landmines.

The most striking part of the volume is its last chapter, which analyzes the amazing resiliency shown by Indonesian MFIs in the face of the country's financial melt-down in recent years.

One of the curses of my job is that I seldom muster the time to read a book like this. Based on the first two volumes, I'll probably declare a couple of sick days when Robinson's final volume comes out, where she sums it all up with a view to the future. (Can I get a doctor's note saying I'm sick of not keeping up with my field?)

Rich Rosenberg

Richard Rosenberg

Senior Advisor, CGAP Secretariat/World Bank

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Subjects of Interest

➤ Pawnshop lending (5 mails)

From: Nimal A. Fernando [nfernando@adb.org] Sent: Mi 22.01.2003 09:11 Subject: Devfinance: Heard of this Rural Finance Institution in Indonesia ?

Dear Colleagues:

As you know, the frontier of rural finance and microfinance can only be pushed outward through cost and risk reducing innovations. The innovations can take different forms. We need to constantly look for these. We can learn from them to improve our programs of assistance.

I would like to bring to your notice of an interesting, innovative microfinance institution in Indonesia.

This is a state-owned pawnshop company - PERUM PEGADAIAN. All of you know about BRI-Unit Desas. But few apparently know about PERUM PEGADAIAN.

I came to know about this only during my recent visit to Jakarta. The following information is taken from a Draft Report prepared by a team of ADB Consultants from Bankakademie International (Microfinance Competence Center), led by Klaus Maurer. (Unfortunately, I did not have time to visit PERUM PEGADAIAN. But Klaus and Ms Sunantar Setboonsarng (ADB Project Officer) who visited this Institution told me that it was impressive)

Why is PERUM PEGADAIAN interesting?. For several reasons.

It has a very large outreach in rural areas. In 2001, it gave 22.2 million loans to 15.692 million borrowers. About 35 % of its clients are farmers, fishermen and small-scale enterprise operators. [For comparison, BRI-Units had only 2.6 million borrowers as at end of 2001].

During 2001, it disbursed Rp5,970 billion (about \$702 million) and at the end of 2001 had an outstanding loan portfolio of Rp1,355 billion. (\$159 million). Again for comparison, BRI-Units outstanding loans amounted to Rp7,810 billion as at end of 2001.

It is the dominant micro-credit supplier in Indonesia. Its loans are small in size About 88 % of its loans in 2001 was less than Rp500,000 in size (roughly less than \$60)

It offers loans against movable assets as collateral.

Its prices are commercial. Interest is charged depending on the loan size and ranges between 1.25 -1.75 % per 15 days with 120 days maturity. Additionally PP charges insurance costs and a deposit fee on all loans.

Its loan recovery rates are high. Collateral is sold when borrowers default: It has auctioned only 0.5 % of all pawned goods.

It offers efficient services: Generally within 15 minutes a client can obtain a loan. Borrower transaction costs are minimal. Administration expenses to average loans outstanding is about 20.75 %.

Total staff of the organization is 6,635.

Its ROA and ROE in 2001 were, 4.5 % and 17.0 % , respectively.

It has a network of 722 branches and 14 regional offices.

It is supervised by the Ministry of Finance.

Based on this information , I have a few questions for the development finance community.

1. Why do we have relatively successful, large rural finance institutions such as these in Indonesia, not in most other developing countries ?
2. Why is this particular institution is less known among the development finance community ?
3. Have you seen any research papers on this institution, published or unpublished ?
4. Do you know of similar institutions with large outreach in other developing countries ?

Hope you will find this message interesting.

Nimal A. Fernando
Lead Rural Finance Specialist
Asian Development Bank
Manila

From: Paul McGuire [paul.mcguire@uq.net.au] Sent: Do 23.01.2003 21:30 Subject: Devfinance: ndonesian pawnshops (posted for John Conroy)

John Conroy is having difficulty posting his response to Nimal Fernando, who wrote about Indonesian pawnshops (Pegadaian). I post the following on his behalf. He writes:

In response to Nimal Fernando:

An earlier ADB report of 2000 (The role of central banks in microfinance in Asia and the Pacific, vol 2) contains my chapter on Indonesia which discusses the state pawnshops in Indonesia (at page 105). I am interested to see that the volume of business they do has continued to grow, after the substantial increase noted in the first year of the financial crisis (1997/98). The earliest reference I could find to the pawnshops in the literature was Ross McLeod's account of them in 1984 (referenced below) which presents a picture quite consistent with this latest account of their activities and efficiency. The relevant passage from my ADB report follows:

"Among NBFIs [in Indonesia] there are also the state-operated pawnshops, said by Bank Indonesia and GTZ [1] to serve as many as 10 million people. In fact that was the figure for 1998, at the height of the crisis. In 1996 and 1997, the numbers had been around 5 million, while in the latter year some 23 million items were pawned (Bank Indonesia Annual Report 1998). Cole and Slade (1996, p.308) [2] describe them as offering important financial services to the poor who hold savings in the form of valuables and other moveable possessions, by enabling them to obtain cash for limited periods at rates of interest close to those charged by BRI Units for *Kupedes* loans. This observation was certainly corroborated by the events of 1998. Cole and Slade quote McLeod (1984, p.95) [3] as saying that "the pawn redemption

rate may be as high as 99 percent, and unredeemed pawns are auctioned without delay. In this respect, at least the pawnshop service is more effective in providing the poor with access to institutional credit than some of the programmes administered by State banks." Data for 1998 (Bank Indonesia Annual Report 1999) which indicate that only 0.7 percent of pledged goods were auctioned that year suggest that operations still conform to McLeod's description. While McLeod's positive evaluation predates the success of the BRI Units, it still serves to describe the current value of pawnshops in the particular circumstances of many poor people".

[1] Bank Indonesia and GTZ (2000) Legislation, Regulation and Supervision of microfinance institutions in Indonesia, Project ProFi, Bank Indonesia.

[2] Cole and Slade, Building a Modern Financial System in Indonesia, CUP.

[3] Ross McLeod, Indonesia, in Michael Skulley (ed), Financial markets and Institutions in Southeast Asia, Macmillan.

As to the ownership and management of the Pegadaian, my study for the ADB contained the following information at page 117:

"Indonesia's only legal pawnshops are a monopoly enterprise operated by a state-owned company. The company issues bonds and notes to raise working capital, which are normally redeemed within the year. In 1998 it also resorted to borrowing from government as well as taking Bank Indonesia liquidity credits to meet the greatly increased demand for loans from the public. It raised Rp350 billion (\$47 million) from all external sources. Turnover was Rp3.1 trillion (\$410 million) for some 10 million customers. The company is profitable, with net earnings of Rp307 billion (\$41 million) in 1998 (Bank Indonesia Annual Report 1999). The pawnshop system is regulated and supervised by the Ministry of Finance and there seems to be no strong argument for changing this".

The point of my last comment above is that I could see no reason for the central bank (Bank Indonesia) to play any role in regard to the pawnshops ('if it ain't broke, don't fix it'). More recently I heard that there was a proposal to privatise the pawnshops, but whether that is proceeding I don't know. My instinct would be to repeat the mantra 'if it ain't broke....etc.

John Conroy

The Foundation for Development Cooperation

From: Dale W. Adams [dwadams@burgoyne.com]
Sent: Fr 24.01.2003 19:36
Subject: Devfinance: Pawnshops in Indonesia

Thanks Nimal for posting information on the huge pawnshop in Indonesia.

Lots of stuff in microfinance has worked better in Indonesia than elsewhere—I suspect—because of population density. Most of the successful microdebt programs elsewhere are located in urban centers where economies of scale in lending are possible. After all, banks and informal finance are also concentrated in areas where there is dense population. One shouldn't be surprised that microdebt efforts are similarly located.

Perhaps a more interesting question is why has Indonesia, unlike most Muslim countries, had so many interesting and successful microfinance activities? Taken to its extreme, the Koran imposes the most severe form possible of repression on financial markets: insisting on zero interest rates. Does it have anything to do with distance from Mecca, or is it just an Indonesian thing?.....jane.

From: Fiebig Michael [Fiebig@Bankakademie.de]
Sent: Mo 27.01.2003 14:09
Subject: Devfinance: More pawning

Nimal, colleagues,

There is another highly interesting case of a development bank with a broad outreach in pawning. The People's Bank of Sri Lanka by end of 2001 had an amount of 12,568 Million Rs (around 135mn USD) outstanding in pawn loans. This constituted around 15% of their total loan portfolio. While the People's Bank struggles with getting their overall loan portfolio back on track (with over 20% classified as non-performing), the management of the bank seems to put strong emphasis on expanding the secure pawning business. In fact, the savings and pawning centres ("sub-branches" concentrating fully on savings mobilisation plus gold-pawning only) in rural areas appear to be very cost-efficient and

profitable for the bank. According to recent reports (and my own experience) pawning has become a highly competitive market in Sri Lanka, with rural customers being able to pick-and-choose where to go for an instant loan - it only takes 10 minutes or so to get the money. Quoting from my memory, these are usually 12 months loans, however most clients will come back after 4-5 months. Many use these loans for bridging funding gaps in consumption, but depending on the location also traders and farmers (e.g. paddy) use these loans.

There is a GTZ project with the People's Bank on rural banking innovations (RBIP) currently considering to work with these savings and pawning centers. Their website is <http://www.microfinance.lk/> <<http://www.microfinance.lk/>> and it includes a recently published study on microfinance in Sri Lanka. In addition, I think John Conroy has also written an article some time back about pawning in Sri Lanka.

Michael Fiebig
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<http://www.international.bankakademie.de>

From: ttimberg@pegasus.or.id Sent: Fr 31.01.2003 06:56 Subject: Devfinance: Response on Pawnshops in Indonesia
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Response on Pawnshops in Indonesia.

Actually, another country with a lot of successful microfinance institutions, in addition, to Grameen Bank is heavily Islamic Bangladesh, and if you mean stuff broader than NGO programs there is a lot of successful microfinance in the Middle East, too. A great deal of this microfinance involves explicit interest, or transactions which economists might feel involve implicit interest.

Many Muslims have either decided that the charges involved are not banned or accept them as a necessary evil. With the rising of interest in closer conformity with Shariah law, in recent years, much lending has been repackaged in Islamic forms. What is involved depends on the varying standards applied, but service charges, leasing, advanced purchase and other modalities have been used for lending. Logically, any transaction can be packaged as a sale, a loan, or a lease, though the default risk may vary depending on the legal and social system which prevails.

More generally the movement towards greater Islamicization of life includes a search for a more just social order—in consonance with Islam (rather than unfettered capitalism) and the form of debt contracts and the allocation of risk certainly forms part of that order. How this works out at the level of institutional detail is obviously open to discussion.

➤ **The future of rural finance (2 mails)**

From: Dale W. Adams [dwadams@burgoyne.com] Sent: Fr 13.12.2002 17:33 Subject: Devfinance: Reincarnations of Rural Finance

Along with increased interest in deposit mobilization, I'm also pleased to see new concern being raised about rural finance. IFAD and the Inter-American Development Bank have both issued new publications on rural finance and the African Development Bank is struggling to define new directions in rural finance. A new book by Dr. Sandaratne and the upcoming conference in Washington in June 2003 on this topic are further indications of renewed interest in rural finance.

Thirty years ago huge amounts of money were spent on agricultural credit programs in low-income countries, both to ease rural poverty and to spur agricultural growth. Partly because of criticism of these programs, and partly because of increased interest in supporting small non-farm rural firms, the term 'rural finance' was coined to cover loans made for agricultural purposes as well as rural deposit taking and loans made to non-farm rural enterprises. In the late 1970s and early 1980s donor support for traditional agricultural credit programs began to collapse and by 1990 donor interest in agricultural credit had virtually disappeared, to be replaced by microfinance, the bulk of which was concentrated in urban centers. Over the past two-decades many of the traditional agricultural development banks that provided financial services in rural areas have been liquidated, substantially downsized, or are essentially moribund. Informal finance and

some microfinance efforts have filled part of the void left by the contraction of development banks, but many farmers and owners of small non-farm enterprises in rural areas in numerous countries have less access to formal and semi-formal financial services than they did several decades ago. It seems fitting, therefore, that some attention again be directed at creating and strengthening financial infrastructure in rural areas where a majority of the poor live, and when most food is grown.

A critical problem in all of this is selecting a general approach to fill the void in rural finance. I see at least five options:

The first option is to focus on rehabilitating and reforming traditional development banks and postal savings systems. Aside from the famous BRI case in Indonesia and a couple of other cases, however, attempts to reform development banks have largely failed. The experience with reforming postal savings systems is so limited that it is impossible to draw firm conclusions about future possibilities in this regard.

A second option is to focus on stimulating commercial banks to shift more of their activities into rural areas. Changes in regulations may allow some of this to occur, especially in deposit taking.

A third option is to extend what has become traditional microfinance lending more deeply into rural areas. I suspect, however, that this approach will not provide many financial services for farmers or for depositors. As currently practiced, microfinance technology is better suited for areas with high population densities and where small, short-term loans are most useful. In contrast, most farmers require larger loans for longer periods, and cannot repay loans on a weekly basis.

A fourth option might be to use financial cooperatives as a way to reach more people in rural areas. But, it seems to me that credit unions work best where members are salaried and live in urban areas. The experience with credit unions dabbling in agricultural credit programs in the past hasn't been pretty. For this reason, it's a bit curious that WOCCU is taking the lead in organizing the June conference on rural finance in Washington. I can see a key role for credit unions in mobilizing deposits. Unfortunately, I come up blank when it comes to credit unions and agricultural lending.

A final option is to continue to ignore the agricultural portion of rural finance and concentrate on expanding microlending for non-farm enterprises in towns and villages. After all, the collapse of agricultural credit systems in a number of countries appears to have had little effect on overall agricultural production. Perhaps so-called agricultural credit isn't all that important in sustaining traditional agriculture, although it is likely much more important in developing a dynamic and efficient agricultural sector.

It will be interesting to see how the reincarnated interests in rural finance play out. I suspect it will largely involve the third option, and as a result, do little to fill the void in rural deposit taking or in agricultural lending.....jane.

From: Paul Rippey [FSD@infocom.co.ug] Sent: Fr 20.12.2002 13:17 Subject: Devfinance: Re: Reincarnations of Rural Finance
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No one else accepted Denis Pommier's invitation to translate his note in response to Dale Adams's reflections about rural finance options, so here is my ten minute effort.

Good morning,

Thank you Monsieur Dale Adams for this synthesis concerning rural finance. I agree with most of your arguments.

However, I would add to the panoply of possible options, that of constructing, with poor rural people themselves, institutional solutions adapted to their problems and needs. Let's remember that the principal institutions of rural finance in the world were born with that specific mission, and were born within, and with the participation of, the rural world, and not outside it.

What the bankers, the MFIs and the majority of foreign assistance programs forget, is that there exist in the rural world economic cycles and strong social networks that are complex, and unique to the rural world. Most failures in rural finance were due not only to political laxity, but also (and above all) to the lack of adaptation of institutions and products to the concrete realities of the field, and to the lack of social ties with the rural people themselves.

The majority of bankers do not understand the economic and social logic of family agricultural production and haven't tried to adapt themselves to it.

At first, those who lost the most with the closure of development banks were not poor peasants, who in most cases didn't have access to institutional financial services, but rather rich producers. These people naturally went to look for loans

elsewhere, notably among pesticide sellers... who were themselves financed by private banks. At the end of the day, the rich producers always have access to credit, directly or indirectly.

Poor peasants generally had recourse to money lenders and merchants, which from an economic point of view is not particularly efficient. In effect, the rent of the money lender is non-productive, it is only a tax on the valued that is added by the producer.

Finally, what does Monsieur Dale Adams mean by "a dynamic and efficient agricultural sector"? that alone would be able to make credit profitable?

What agriculture are we talking about here exactly?

While peasant agriculture is almost everywhere mired in misery, and the number of poor rural people continues to increase, isn't it finally time to create the political conditions that permit the strengthening of more efficient family agriculture, better adapted than industrial agriculture (with permanent employees), by offering financial services adapted to these needs (savings, insurance, credit).

Furthermore, let's not forget that the principal problem today isn't access to financial services for rural people, but the crushing competition that the richest countries are inflicting on peasants working with hand tools. As long as the prices for these family agricultural products don't rise to a profitable level, family agriculture will be compromised.

And the financial institutions oriented towards this sector will have all the difficulty imaginable to be financially viable, an outcome which runs against everyone's best interests.

Amiably,

Denis Pommier
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➤ Thinking "credit plus" (4 mails)

From: Linda MAYOUX [rcy12@dial.pipex.com] Sent: Fr 22.11.2002 14:26 Subject: Devfinance: Re: MCS +5 follow up

Dear colleagues,

Were any of you at the recent Micro credit Summit +5?

On a positive note there is an increasing diversification of models and recognition of the viability of self-managed models linked to the formal financial sector, particularly as a sustainable solution for rural areas.

In the sessions I attended two very key issues seemed to emerge:

- 1) A concentration of many donor agencies and programmes away from the poorest in order to fulfil the Millenium Development Goals with limited budgets. It is much cheaper to get the 'just below the poverty line poor' above the poverty line to fulfil the targets than to address the underlying poverty of the extremely poor. But these people also have a right to financial services and it is unclear where the grants and welfare services which are supposed to be replacing MF in this scenario are coming from. Credit may be used to finance labour-saving technology and often leads to saturated markets and price distortion which adversely affects the very poor excluded from MF services. There is an urgent need for a clear debate on who is meant by the 'very poor' - possible ways of addressing the

needs of landless labour, the disabled and chronically sick either through explicit inclusion in existing programmes or special targeted schemes. Some programmes are working on this.

- 2) A general agreement that from a development perspective we need to be looking at 'credit plus' but no clear idea of what this is or how it can be funded. A number of NGOs which have set up separate MFIs with parallel NGOs have now found their NGOs collapsing. There is a need for donors particularly to take a longer term and more developmental perspective towards MF as a poverty reduction strategy like education and health.

On a positive note there is an increasing diversification of models and recognition of the viability of self-managed models linked to the formal financial sector, particularly as a sustainable solution for rural areas.

Maybe I am missing something here?

What were your impressions?

Linda

From: Betty Wilkinson/IRIS Zambia [iris@zamtel.zm]
Sent: Mi 27.11.2002 10:08
Subject: Devfinance: Linda Mayoux' note on the: MCS +5 follow up

Linda,

Thanks for this snapshot for those of us who couldn't make it to New York. The issues you raise are cogent. A few comments, and apologies in advance if I am mis-applying others' views:

Commercialization etc: for a few years now there has been a schism developing between those who see microfinance as an emerging commercial (or at least break even) process and those who see it as a barely break-even obligation to financial service provision to the poorest. On the side of obligation is the question of poverty and a World Bank study demonstrating that deeper reach of financial services provides faster and more equitable economic development. (now if only I could remember the cite!)

On the side of commercial, we have all realized that linking up MFIs to the rest of the financial sector is critical to long-term sustainability (hence all the recent interest in legal and regulatory structures, transparency, performance criteria, ratings systems, wholesale lending processes, ownership and governance.) And it seems clear that this work has focused more on the "winners" who have already gotten lots of donor money and have reached trigger points of self-sufficiency and expansion. My biggest objections are mainly about how investments are made and managed in the market. The argument that so few MFIs will be successful is true precisely because the microfinance investors aren't careful enough yet about how they invest. Then, when burned, MF investors focus new investment on larger, successful, already established firms. This blocks out precisely the kinds of small firm entry and new innovation that made microfinance exciting in the 80s and 90s. Instead of making the right kinds of investments, microfinance investors often put too little money at the wrong time in the wrong ways. And they never watch the investments closely enough to ensure fast correction when something goes wrong. If banks and leasing companies were set up this way, we would see about a 3% success rate too... and chaos in financial markets. So it seems to me that commercialization and market development need to involve better general guidelines about MFI financing, encouraging innovation at the small end too coupled with more rigid rules about the institutional basics (accounts, management, transparency, local linkages).

And yes Linda, it is very clear that these MFIs serve the "just below the poverty line" people, those clients most likely to be able to take a loan and turn it into rapid cash and diversified income sources to repay the loan. This has emerged most dramatically in Africa, where new MFI investment is focused on urban middle poor with diversified income options, not rural very poor who have few options and lower market access. In some ways I think this is short-sighted, since the assumption that once these MFIs are established they will reach out to rural areas is naive. Rural finance is still a significant challenge to say the least. Mark Wenner's IADB paper in this regard is definitely worth reading.

The ownership question cuts at the core of what regulators are struggling with. How can they justify licensing an MFI if the investor has only guaranteed part of the money needed to reach break-even? (The bank supervision guys laughed so hard they cried at even considering such an option.) Can an NGO owner of a corporate MFI pay up if there is a capital call? How do donors justify grants to institutions that will end up with sets of owners who might benefit later from profits (or worse, close down the MFI and walk off with the money?) Which of course argues that we are likely to see a schism here too: commercialized MFIs with commercial owners, and those MFIs providing services to the poorest

potentially being subsidized for a long time. This of course is what I understand that Morduch argues. But the focus has been so much on microfinance being developmentally self sustainable that no one wants to look inside this door.

Where I come out on the poverty question is that we need to provide the services that the poorest need in more innovative ways. Rutherford and Hickson are spot on target: savings. And with ASA's experience of this, we can see that this won't necessarily be a profitable process for some countries or institutions. Recent studies on transmittals of funds also show the importance of these to the poor (nice work on Latin American receipts showing they dwarf development aid) but we have not looked enough at this. Then there is the insurance thing, but I leave that to Monique Cohen and those looking closer at this. So where we have focused on donor funds paying for institutional development for microlenders who deal with the middle poor, they may not be able -- or willing -- to take on services that are pitched to a lower income group with different kinds of service needs and much less ability to pay for them. Should we be surprised when an MFI lender that has aggressively sought size and self-sufficiency balks at experiments providing services to a different group which will probably be more costly and lead to losses for some time?

Look forward to more on this.

Betty Wilkinson

From: Linda MAYOUX [rcy12@dial.pipex.com]
Sent: Mi 27.11.2002 12:15
Subject: Devfinance: Re: Linda Mayoux' note on the: MCS +5 follow up

Dear Betty,

What really worries me is not assertions of the need for and promotion of commercial MFIs serving the profitably bankable poor - this is certainly an important part of the picture. It is rather the gearing of all 'Best Practice' towards this model rather than really looking at issues of diversification for different contexts and target groups - not so much a schism but a jigsaw.

There is a lot of resistance to even considering the issue of continual subsidy of programmes which can show their effectiveness in developmental and poverty targeting terms. This also requires a lot of innovation and different types of 'Good Practice'. It needs to go beyond the current enthusiasm for savings and insurance - these are no more panaceas for development than anything else. It needs to really examine the credit-plus issues and how 'joined up services' can be designed to avoid the mess of many previous 'holistic approaches'. The current enthusiasm for market BDS reinforces rather than mitigates the drift away from poverty targeting - though again it is part of the picture. At the MCS people were talking about grants for the very poor and welfare but all these have been cut and I don't see any move beyond rhetoric on this front (maybe I am wrong here?).

The other worrying trend is a decrease in donor funding for MF now as if 'the job is now done' so they can now move on to another fashion rather than the serious development work just really beginning now. The organizational base which group-based services provide can be a real ongoing and regular structure for empowerment and local-level lobbying (see for example some of the papers on the One World Action website www.oneworldaction.org in the section on MF and women's empowerment)

Linda

From: Imran Matin [comimatin@hotmail.com]
Sent: Mi 27.11.2002 15:23
Subject: Devfinance: Fw: Devfinance: Re: Linda Mayoux' note on the: MCS +5 follow up

Thanks Linda, for the emphasis you placed on the real challenge of innovations that 'join up services in ways that does not repeat the earlier mess of so called 'integrated rural development programs'. This allows us to explore microfinance innovations within a much wider and (dare I say) more meaningful canvass. This also I think, allows us to leverage the poverty alleviating potential of the microfinance *institutional* framework.

BRAC's experiences in developing operationally separate but conceptually joint programmes can be quite insightful here. BRAC has taken on the challenge of including the poorest through such an approach. The IGVD essentially is a fine example of this. It uses the food aid safety net programme of the WFP/Government as a platform to provide training

and later credit to those who are normally left out of the usual microfinance programs (for details see the CGAP FN by Hashemi). The microfinance component is operationally completely independent here.

Such a ladder approach is now further experimented through a new BRAC program called 'Targeting the Ultra Poor'. This program will not only add rungs in the ladder (through direct asset transfers, more focussed training, etc.), but will also be much more attentive to the vulnerability dimensions of the extreme poor's lives that eats into any small gains they manage to make using more promotion-oriented mechanisms. In addition, the importance of increasing the socio-political assets of the extreme poor and advocating for them at various levels of policy, are crucially recognized. Experiments with more suitable forms of microfinancial services for the extreme poor will also be conducted so that the link is more useful and secure.

We need to understand these types of approaches much better—both the conceptual underpinnings and the operational details. The spirit of such approaches should constitute the 'second generation microfinance challenges' agenda that takes poverty-focus of microfinance seriously. The job is far from done...

Regards,

IM

Imran Matin, PhD
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