Devfinance

Discussion list on development finance of the Ohio State University

Quarterly Review

January to March 2004

Discussions

➢ From interest rates to business models and efficiency:

***From**: nfernando@adb.org [mailto:nfernando@adb.org]*
***Sent**: vendredi, 30. janvier 2004 01:13*

Dear DFNers:

Many people in the microcredit industry have argued in support of high interest rates on the explicit or implicit assumption that the demand for microcredit is highly interest inelastic. The rates have been justified primarily on the basis of the need to be sustainable and thought of as essential for expansion of both breadth and depth of outreach. This assumption has been questioned for sometime, among others, by Morduch. I want to revive this debate.

I do believe that it is high time that we move away from the nearly one-track approach to sustainability if we are to expand the outreach substantially. There is evidence that high interest rates are being used to pass on institutional inefficiencies though this should not be the case. Also, high rates keep many potential clients out of reach. To assume that there are so many enterprises that can earn real returns in the range of 20 -60 % on their investments does not seem realistic, although I admit that there are some economic activities with such returns. But with competition the returns also come down, though in many countries effective interest rates have not come down in real terms. I firmly believe that high rates put most investment opportunities beyond the reach of poor. This may be why that most MFI clients also cluster around the poverty line.! Secondly, most poor households borrow for other purposes such as for payment of school fees, medical bills, and a variety of life cycle events. Can we safely assume that the demand for such borrowings is not frequent.? Can they afford to borrow for these purposes at the rates that many MFIs charge on credit ? These are important questions for which empirical evidence is needed. My argument is that many poor households are unable to afford microcredit at these rates and hence stay out.

Also, even with high rates, many MFIs are unlikely to move into areas where there is poverty concentration. This is because such areas are also characterized by poor infrastructure and other problems. The poor in these areas suffer from inter-locking disadvantages. Take for example India. More than 75% of microfinance outreach in India is in southern states. Almost half of India's poor and 1/3 of the population are concentrated in Uttar Pradesh, Bihar and Madhya Pradesh. But microcredit has not penetrated these plus, other states with high poverty incidence such as Orissa, Maharashtra and West Bengal. Microcredit is unlikely to penetrate these areas unless infrastructure related issues are addressed, even at very high interest rates. The same is true for the western region of the People's Republic of China. In most countries in Asia, there are such regions and pockets of ! poverty unlikely to be penetrated by microcredit. But they contain bulk of the poor.

This brings me to my main point. Two things are essential to expand microcredit and other financial services to the poor .

First

(i) focus on efficiency of operations and new business models that can address the fundamental issue of high cost of microcredit services. This requires a major re-focus, not just tinkering on the now "old delivery

mechanisms and techologies". As Mordocuh noted in one of his articles we need "to take another hard look at management structures and mechanism design in order to lower costs". In my view there is lots of potential for learning from the corporate business world - in both services and manufacturing - on how to make progress in the areas of cost efficient delivery mechanisms. This does not happen right now mostly because microfinance industry people tend to presume that it is a unique industry. Is it actually so ? Or can we learn from other industries ? "lean technology, lean business models being applied in other sectors have some relevance if we care to look at these serio! usly.

Look at what is happening in no-frills airline industry. How did Southwest Airline model spread and became a competitive force ? How did Unilever got interested in mini-packages and began to penetrate bottom of the pyramid market and made, and continues to make, big profits? Dont we have lessons in these for the microfinance industry?

Second

(ii) A major investments in infrastructure is essential in areas where there is high degree of concentration of poverty. There is mounting evidence that social returns on investments in these areas are high. Also, according to Fan and Peter Hazell, " it now seems plausible that increased public investment in many less-favored areas may have the potential to generate competitive if not greater agricultural growth on the margin than comparable investments in many high-potential areas.."

One- track microcredit promoters seem to have ignored the impact of these other investments and the importance of these other factors for the growth of the microcredit and microfinance industry. Also, those who always talk about policy environment and legal framework have also ignored these, unfortunately. High time to take a fresh look at what we all have been doing and whether our approaches will lead to financial services for a majority of the poor.

I would like to hear your views on these issues and ideas.

Thanks

Nimal A. Fernando
Lead Rural Finance Specialist
Asian Development Bank

***From:** Ramesh S. Arunachalam [mailto:r_arunachalam@hotmail.com]*
***Sent:** vendredi, 30. janvier 2004 09:34*

Dear Nimal,

I could not agree more with you.

Being sustainable is not merely a function of charging appropriate interest rates.

If one were to factor in competition (which is still at its infancy in the micro-finance sector), truly sustainable institutions are those that are **efficient, effective and adpative**. Business history and the seminal works of Alfred Chandler, Herbert Simon, Oliver Willamson, Ronald Coase and empirical work of many others has consistently shown that.

Charging higher interest rates and passing on ineffiiciencies (and related costst) to the clients will work only as long as there are no alternatives. The case of the **Urban slums in Chennai** in India where I have been working with MFIs clearly shows that.

In urban Chennai, access is getting to be less important now (it was some 25 years ago) as we have a very long history of m-f type programs and today, clients are demanding much much more - competitive services in terms

of quality, price and differentiation (value addition) and MFIs that are not market responsive are loosing a large chunk of clients.

This is forcing MFIs to adopt low cost methodoligies including using mature clients as field workers and office bearers and the like, reducing transactions cost through appropriate automated teller systems and the like and so on.

In fact, The SDI's prespcriptions (as I have used it) are very useful:

Sustainability is a function of:

a) having access to low cost sources of non-subsidized capital like savings (which reduces the subsidy on borrowing);

b) having a lean organization and efficient methodology which is reflected in lower operational costs and higher profits

c) having appropriate products and a sound efficient methodology,which should keep delinquency low and hence, result in lower provisioning and reflect in higher profits

d) having a larger number of active borrowers and provide]ing deepened and responsive financial services to them, which would manifest itself as a larger outstanding portfolio, and

e) having an appropriate interest rate, which enhances profit and enhances return on portfolio (provided delienquency is low and well managed and the method of appropriation of clients repayments is in proper sequence - panelties first, interest next and prin. last)

While combination of a), b) and c) reduce the numerator and move it towards 0 or negative (more sustainable),

d) and e) increase the denominator and reduce the SDI overall, making it closer to '0' etc

Hence, as the SDI shows,

an institution is truly sustainable when it has all of the above conditions and merely focussing on interest rates can prove dismal in the long run as the case of some MFIs (in India) which clearly have had as high EIRs as 55% and not been sustainable by any means. Also, they begin loosing clients to competitors even such as informal money lenders (some of whom lend at 36% annualized) - pricing is related to people having choices and competition in the area and where m-f has been in existance for many years and there are alternatives, clients are beginning to demand quality services - not just in terms of differentiation but also in terms of pricing and MFIs have to become lean and efficient organizations.

Sincerely

Ramesh S Arunachalam

From: *Miller, Calvin [mailto:miller@care.org]*
Sent: *vendredi, 30. janvier 2004 14:50*

Nimal,

I agree with your observations. Whereas interest rates are highly interest rate inelastic for short-term "high-velocity" working capital loans, especially in under served areas, this is not the case for many of the poor and poorest whose returns to capital are less. Agricultural lending, except in irrigated or multi-crop per year environments, is one vivid example of this. Also, as you note, many of those living in areas where microcredit has not had significant penetration are hindered by a lack of infrastructure -- a double hit since the entrepreneurial profit options are less and the cost of service delivery of microfinance is less.

Living near the world's busiest airport in Atlanta, I liked the airline analogy you used. Our local upstart airlines is doing great and the mighty Delta is struggling. Delta's eliminating of most meals, charging for headphones and reducing the number of pretzels will not make them more efficient and cut their red ink. Neither will higher fees

and fares, but rather some fundamental retooling of their products and service delivery are required. The same holds true reaching the more difficult markets in microfinance.

I do however believe that we have many examples of innovations and approaches for doing this that can be built upon -- savings products, financial linkages, finance through input and output market structures, highly efficient MFI portfolio management and communication technologies, etc. I also believe that as more and more MFIs add diversified product lines, as opposed to a one type of loan fits all, we will also see increased opportunity to reach the unreached.

Calvin Miller
Dir. Econ. Dev. - CARE

From: *N.Srinivasan [mailto:shrin@vsnl.net]*
Sent: *vendredi, 30. janvier 2004 16:14*

Dear Nimal,
I totally agree with you on the entire question of interest rates in mF and the need for a more efficient structure and facilitating infrastructure to allow for penetration of microfinance.
What I have been writing in Devfinance and elsewhere over the last three years on high interest rates has been admirably summed up in your post.

On high rates my reservations have been on account of
a) the lender takes only a credit risk and deserves a price that includes risk premium on the credit - the lender does not take the enterprise risk and hence cannot partake of the potential returns to the borrower in the name of high returns.
b) the lender should not pass on the inefficiencies of operations to borrowers in terms of high costs - lenders with inappropriate business models - with badly designed products and flawed delivery channels end up burdening borrowers with usurious costs.
In the Indian situation, quite a few MFIs are facing difficulties in matching the low rates of interest charged by the banking system to mf clients - the difficulties are on account of low business volumes, low staff productivity and product and business models that are cost intensive.
Your point about infrastructure availability impacting costs and credit penetration is indeed very correct. The State has a responsibility to provide the infrastructure that would enable the financier to run the operations with a minimum of effort and costs. I would also include the need for a positive business climate - in terms of appropriate legal systems, established norms, protection to borrowers and lenders alike from each others deviant behaviour, norm based supervision and level playing field for competing institutions to thrive- as requisite for penetration of credit services.

Best regards
N.Srinivasan
National Bank for Agriculture and Rural Development
Mumbai, India

From: *Staschen,S (pgr) [mailto:S.Staschen@lse.ac.uk]*
Sent: *vendredi, 30. janvier 2004 17:17*

Dear Nimal,

I agree with many of your points and I commend you for bringing them up. It would be completely misleading to assume that poor people do not care about high interest rates - they do, even though their demand for loans might be highly inelastic.

I have a couple of comments/additional points with regard to your posting:

- I fully support your request for more empirical evidence. We simply do not have much evidence about the returns of typical investments financed by microloans (anyone out there who can recommend such studies?). If the loan is used for consumption, it is easy: the immediate return is 0 % (even though the long-term return e.g. of paying school fees might be higher), i.e. the repayment of the loan must be financed out of other income. If the money is used for investment purposes, the return must not necessarily be as high as the effective interest rate of the loan. Many microloans are only used to supplement other sources of funds (e.g. savings), which can be much cheaper. Thus the **average** cost of funds for this investment can be much lower than the cost of the microloan.
- You are talking of 'one-track microcredit promoters'. I agree with your observation. Looking at it from the perspective of a microfinance institutions, which is trying to attract donor funding, there seems to be a perverse incentive structure. At least to my knowledge, donors are much more interested in sustainability indicators (and repayment performance) than in efficiency ratios. So why should I as a microfinance practitioner put too much effort in cost-reducing measures, if it is much easier to reach the targets of my donors by simply charging higher interest rates? As long as there is not much competition, demand would not suffer much and I could still make a profit just by being a little bit cheaper than the local moneylender. The interest rate elasticity of the demand for microloans depends on the borrower's next better alternative: If this is the local moneylender, even highly inefficient MFIs recovering their costs through charging very high interest rates might for the borrower still be the cheaper source of loans. Thus simply looking at the elasticity might be misleading.
- The question which arises is: what is the best strategy to bring down interest rates? I think there is no question that the rates are often too high, but there is a lot of disagreement about the best cure. In my experience, two main cures are discussed: 1) increase competition in the market to bring down rates through competitive pressure (advocated in most microfinance 'best practices' documents) and 2) simply restrict the interest rate which can legally be charged (disturbingly popular among many politicians). 2) can easily be ruled out (even though it is still widespread in practice), as there is vast evidence that interest rate caps are counter-productive, i.e. hurt those customers most, which they are trying to protect.
- 1) sounds good and can potentially be very effective (combined with transparency enhancing measures and consumer education), but is often not easy to achieve in the short-term (especially in more remote rural areas). What we need, I think, is a discussion on the appropriate way to use subsidies in outreach-enhancing measures. You are advocating for major investments in infrastructure. What kind of infrastructure do we need, what gives MFIs an incentive to move out into rural areas, how do we deal with double standards (full cost recovery in urban areas, subsidised microfinance provision in rural areas), who pays for it?
- What role can donors play in this? Certainly, they can play a role in financing investments in infrastructure. But they can also play a crucial role by not only looking at the (often ominous) repayment rate and OSS/FSS, but also at major indicators for the efficiency of operations (the MicroBanking Bulleting is doing a great job in this regard). They can support initiatives in customer education and information disclosure so that clients are able to make an informed choice.
- Finally, I feel hard-pressed to say something about the role of the legal environment as I am one of "those who always talk about policy environment and legal framework". It is my strong belief that the regulation and supervision of the microfinance sector on the one hand and the support of infrastructure investments, the use of new business models and other promotional activities on the other hand must be stricty kept apart. The first is the role of the government regulatory authority. The latter can be the role of the government, donors, social investors, ingenious innovators, etc. Regulation has a strong role to play in improving disclosure (such as efficiency indicators for MFIs' operations). But it should not interfere with management decisions such as the question what kind of efficiency-enhancing measures could be chosen. Improving the infrastructure and enhancing the outreach of microfinance is not a role for the regulator, but for the government through its relevant ministries.

Stefan

➢ Cooperative policies and capacity building: example of FECECAM

***From**: galor [mailto:copgalor@actcom.co.il]*
***Sent**: mercredi, 25. février 2004 17:22*

Hello Peter,

I would like to bring you a story, almost old one, of ten years ago, with the FECECAM of Benin.

About 10 years ago, I was invited as resource person and leading of the programme, by the I.L.O., of a leadership workshop at the ISPEC in Cotonou, where more than 30 participants from 11 francophone countries of west africa took part.

At the opening ceremony, each participant has presented him/herself, the organisation and the country from where s/he came.The representative of Benin, the head of the FECECAM spoke about his cooperative federation, at that time covering all the southern half of the country.

He detailed the activities of the federation, and between other things he mentioned that all members of the federation as been saved the accumulated amount of 6.000.000.000 FCFA. Immediately, the director of the ISPEC, at that time, asked him how much they allocating as credit to their members, out of this sum.
The answer was: 1.500.000.000 FCFA. (25% of the total available resources)
He was asked again: What are you doing with the rest of the money. He answered that the rest, 4.500.000.000 FCFA is deposited in the commercial banks in Cotonou.
The banks, at that time, paid 4% annually, on fixed deposits. They charged 18% on credit allocation. The annual rate of inflation at that time was, as I remember, 12-13% annually.
The meaning of this policy is that when FECECAM is depositing 75% of its financial sources in banks, it loses, on the real value of the money ~400.000.000 FCFA annually. The deposited money, could have been credited to members to generate productive projects. This money didn't serve the members needs. He explained that they act in this way on instructions given to them by ACOSCA. This was confirmed by the representative of FUCEC Togo in this event, so we may assume, that this was the policy of most of the financial organizations in this part of the world.

Regards
Zvi Galor

***From**: Marx, Michael (TCIW) [mailto:Michael.Marx@fao.org]*
***Sent**: mercredi, 25. février 2004 18:09*

Dear Zvi,

The story about FECECAM did not stop there. The network obtained a rather big amount of funds for onlending and capacity building in the early 1990s through a multilateral agency loan in order to expand the membership base and increase lending. However, recovery rates decreased almost gradually during the rapid expansion period to somewhere around 70%. If one would have applied normal standards, the network would have to be declared bankrupt at the end of the 1990s. The message is simply that different types of financial institutions have their different management (and recovery) capability, and that expanding that capacity in the case of a rather big network of decentralized institutions is quite a challenge. While the very prudent, or even over-prudent policies of some cooperative networks, and of ACOSCA, may not have served members well as their capital was constantly eroding, this approach at least kept the institutions going, and did not expose them to too big risks. The criticism of the old approach, plus the 'carrot' of the funds, produced a swing to the opposite, which put everything at risk what had been created over the years. As none of the 2 approaches works, we need to ensure that we promote

prudent expansion patters, careful analysis and balancing of risks and opportunities, and sound management practices, complemented by the right dose of capacity building and market-oriented incentives.

Best regards
Michael Marx

PS: The 2001 Implementation Completion Report of the above project rated the
overall project outcome as "satisfactory".

From*: Nanci Lee [mailto:nlee@stfx.ca]*
Sent*: mercredi, 25. février 2004 18:14*

Hi all,

We had a similar issue as FECECAM in our microfinance course last year. SEWA Bank (India) was the case-study and Jayshree Vyas, Managing Director, was co-facilitating. She presented that roughly 80% of the source of funds come from member deposits but only half of that is lent back out to members. About 50% of funds are invested in a local bank.

The participants of the course asked why more was not lent to members and Jayshree explained that absorptive capacity was one reason. The other was that the Board, comprised mainly of members, had decided that the Bank should not open membership or lend any further up-market because they would be straying from their mission to focus on poor, self-employed women.

A fascinating debate ensued: which is more “up-market”—opening up membership and lending to relatively less-poor members or giving your money to banks who will inevitably lend to even less-poor clients?

Food for thought,

Nanci Lee

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From*: Christian Loupeda [mailto:cloupeda@freefromhunger.org]*
Sent*: mercredi, 25. février 2004 20:36*

Dear All,

I concur with Michael conclusion about the negative impact of external loan funds on FECECAM's financial situation. This is what is called "Argent froid" in the West African large Credit unions networks; meaning "easy money" not coming from the members savings (as opposed to "argent chaud").
There is an increasing discipline in these organizations to minimize as much as possible the risk associated to the use of members savings. Some of them like FECECAM, have quite powerful boards focusing on that issue.

The issue regarding their excess of liquidity is a key one and needs to be dealt with if we want to have financially solid and sustainable organizations in an increasing competitive environment where organizations such as

PADME (Benin) are operating. Most of the West African Credit union network are more and more concerned about that, at least those that are FFH partners (FECECAM-Benin, FUCEC-Togo; Reseau des Caisses Populaires in Burkina, Nyesigiso and Kafo-Jiginew in Mali). This partnership contributes to help them to have a better use of their liquidity with a risk minimum(excellent repayment rates) through the implementation of credit with education product. I have noticed that West African credit unions are more and more conscious of that; of course there is still a long way to go...

Christian.

***From**: Ahmad Jazayeri [mailto:ahmad.jazayeri@fsa-international.com]*
***Sent**: jeudi, 26. février 2004 08:08*

In our experience with FSAs in Uganda and Tanzania which are similar to FECECAM branches, the source of their money (hot or cold) has nothing to do with their arrears levels. FSAs with good management performance do well regardless of the origins (cold or hot) of money and poor performing FSAs can mess up with their own money as much as with external money. The real issue is to have a proper loan appraisal, loan tracking (preferably computerised), and loan recovery system so that PAR can be reduced to 10% or less. Of course if they are flooded with money and they have to pay back interest, they may loosen up and lend quickly and make mistakes but this can also happen with their own money. I think the cold versus hot money issue is probably relevant only for very small rotating groups. With FECECAM and FSAs with hundred (or thousands) of members, this distinction becomes irrelevant and the focus should be on management systems, MIS, training, audit, contract enforcement, etc and not with medieval philosophical distinctions.

Ahmad Jazayeri

***From**: van Dijk, Peter [mailto:PvanDijk@imf.org]*
***Sent**: jeudi, 26. février 2004 10:57*

Two issues:-

1. What is the excess liquidity, what nature, what term? As I said earlier, many savings in West African credit unions are linked to loans (pre-condition, "security"), and much of the voluntary savings appear to have a short term character, can be withdrawn at any time and have an average deposit term of one month (as much as the banks have here also, also preventing them to on-lend on medium or long term, what donors and governments would like them to do). What does it mean when a borrower certainly repays after one or two years, but the financial institution is insolvent now because it could not pay out depositors' money?;

2. Did the credit activities of credit unions, the women borrowing groups (incorrectly called "caisses villageoises" as they are not autonomous village banks but borrower solidarity groups managed by the financial cooperatives), really result in better fructifying their liquidity? In early 2000, I remember having seen repayment rates of the women groups of Burkina's caisses populaires averaging 65% with the oldest group only having 55% repayment. If I am not mistaken, also elsewhere in the world the near 100% repayment rates of women solidarity groups with high interest rates boasting MFI's profitability, often created and supported by "cold" (donor -charitable donors promoting high profits?) money, have been demystified. Women groups, as all groups, are dynamic, with some members being more entrepreneurial than others, some being better able to hold off pressures from families to mix borrowed money with other activities, etc. all such dynamics resulting in weakening solidarity. Such dynamics, together with the limitation of products, pressure for more and more important loans, creation of new financial co-operatives with external capital for the sole reason of accessing loans, and few savings products, often result in high departure rates of members and a high turnover of new members which again leads to weakening solidarity. This is no rocket-science. What elements in women group lending can be added to the discussion (exluding loan restructuring techniques) that ensures continued near 100% repayment rates?

It would certainly help the discussion if FFH could share with us the risk profile of the loan portfolio (non-/late repayment rates of 30 days past due if possible), the average effective yearly interest rates and the profitability figures of the Credit with Education product with the West African credit unions you mention over the last three years.

Regards, Peter

***From**: van Dijk, Peter [mailto:PvanDijk@imf.org]*
***Sent**: jeudi, 26. février 2004 11:40*

Pardon me Mr. Jazayeri,

Are you stating that sources of funds, especially when they are non-commercial, non-risk bearing, have nothing to do with performance of financial intermediation, with risk management, and that making such distinction is irrelevant and medieval philosophical?

I do agree that management is a core issue, but as is the source of money, its conditions and terms.

You give a whole new meaning to mediaval philosophy and financial intermediation. Maybe you should inform the Basle Committee. Let me ask a question: would it have an effect on USA's banking system when the money its citizens, enterprises and government now owe to foreign governments and financial institutions, would be transformed into grants? Would it not influence risk management of the loans managed by local banks? What would Greenspan think? I am sure it would make the President happy, maybe less his advisors. In many countries commercial banks argue that their competitors of the credit unions and co-operative banks have an undue advantage of having lower supervisory and management costs, influencing their bank management costs.

On FSA, may I know how much donor money goes into your management, supervisory and TA activities and how many total active clients you have in Uganda? The relation to cold money and your ability to ensure good management of how many active clients could constitute a good indicator to follow. In your opinion, is continued external (donor) funding of strong management of the FSAs by FSA International essential for sustained growth of the FSAs? What does it mean for the sustainable development of local financial systems, what does it mean to competition with local organisations that have no access to such funds and what will it not influence the regulatory and supervisory framework? I do hope you agree with me that these are pertinent, not philosophical questions (although I seem, reflecting on what the word actually means, to attach much more importance to philosophy than you do).

Regards, Peter

***From**: Ahmad Jazayeri [mailto:ahmad.jazayeri@fsa-international.com]*
***Sent**: jeudi, 26. février 2004 13:30*

Thanks Peter for some good responses.

Why should appraisal or recovery procedures change just because of the source of the money? Money enters the pool of the Credit Union/FSA's loanable funds fed by many sources and it would be difficult to single out which loan comes from which money. Poor results come when loans are dished out through poorly trained and sometimes corrupt credit committees with poor verification and appraisal by managers or loan officers, when loans are made to friends and not followed up, when managers don't even know their PAR, when salaries are not linked to performance, and when there is no IMS to quickly show the impact of arrears on the bottom line.

Regarding the debt of the US, I would think that professional bank managers being guided by commercially minded boards would put the money into best use and get the best returns regardless of it being a grant or a loan. Economics teaches us that rational use of resources involves looking at the opportunity costs and putting the money into best use regardless of the source of money. In fact I am not aware of any theory of economic behaviour associated to the source of funds. Even New Institutional Economics that emphasise social capital and institutional factors does not yet have a theory of sources of funds. Commercial banks can make very bad loans while charities could be exceptionally good in promoting small enterprise through cheap loans. It is all in the management and in the contracting process.

The debate about putting in money into FECECAM dates back to early 90s. I designed a revolving fund of, as I recall, USD 400,000 through an IFAD funded project for the FECECAM network for the cotton growing areas in the North. The Swiss board members actually objected that this was cold money and it would undermine the system. The project went ahead anyway and the funds were disbursed. In the following 3 years, these funds actually met the loanable funds requirements of cotton farmers in the North and the repayment rate were quite OK at the time. In fact as I recall the FECECAMs in the North did better than the ones in the South of Benin where there is more subsistence farming and I believe the reason was staff quality, better management, and above all, volume of business.

On FSA, FSAIU did receive a substantial grant into promoting, training, and supervising FSAs which we did. The supervisory system is now 40% self-sufficient and perhaps, for the first time in Uganda or anywhere else in Africa, the clients (FSAs) are actually willing to pay for supervision services and they do. We have 31 FSAs and 14,000 shareholders/clients with about 4000 active loans and about 8,000 active savings accounts. Our ultimate success would depend upon our ability to make the entire supervisory system sustainable over the next 3 years with about a total of 60 units under supervision. Most of the funds are from shareholders or "hot" according to your definition but FSAs have received external loans to finance up to about 25% of their portfolio in the past 2 years. The money was paid back. The real problem with external funds is not because they are cold or hot but related to the duration in which the loan must be repaid. A short duration of say less than 7 months can affect them negatively and create a cyclical effect on their income and lending activities and this is not healthy. Actually this is one of the criticisms that can be made against some of the suppliers of concessional finds currently operating in Uganda. What is needed is an extended loan term of 3 to 5 years or more – essentially like a line of credit. This could produce major benefits to the system but again subject to good management and volume.

FSAs do compete with other MFIs especially with the Microfinance Cooperative Savings and Credit Societies and do so successfully. People now see the FSA as a brand and trust it much more than the local politically infiltrated cooperatives that often collapse because of fraud, embezzlements, and poor loan recovery and the culprits are not prosecuted. Unfortunately the Registrar of Cooperatives who according to the Cooperative Law (1991/1993) has extensive powers, can hardly use them because of lack of supervision and enforcement capacity. Therefore, cooperatives in Uganda are largely unregulated and unsupervised hence making FSA International's works in this sector very significant allowing us to hopefully rescue the idea that self-managed community based microfinance can work if properly trained and supervised.

On Philosophy, I was not trying to undermine its importance which I value greatly but I had in mind the scholastics who used concepts such as up and down or hot and cold as absolute concepts and not as relativities. Earth was supposed to be the centre of the universe - again as though there is such a thing as an absolute centre. My reference to medieval philosophy was because I see the use of the concept of cold money and hot money to have the same medieval absolutist flavour. How cold is cold? Is hot cold compared to hottest? "Hot" money from members is in fact much easier to manipulate through social capital ties than "cold" money of donors with a lot accounting strings attached to it.

Regards
Ahmad Jazayeri

***From**: van Dijk, Peter [mailto:PvanDijk@imf.org]*
***Sent**: jeudi, 26. février 2004 13:51*

How much is the total of external funds, in relation to 31 FSAs with 4.000 active loans and the results have been reached over how many years? These data would enable to calculate growth rates and relate to the support provided. Then you can get a sort of return on investment, depending on the definition of course of investment.

Interesting info about having 4.000 active loans and double, 8.000 savings accounts. Am I right that FSA's only have savings accounts as a service to non-members? Aren't FSAs for local investors-business people that are member, pool money to lend to colleagues? Has practice evolved? Could you explain the amount of savings, the products and trends?

Regards, Peter

***From**: Didier Thys [mailto:DThys@themix.org]*
***Sent**: vendredi, 27. février 2004 16:15*

Peter,

1. The Credit with Education product was basically integrated into credit unions with no external refinancing other than coverage for technical assistance, training and some initial operating expenses to hire new loan officers and get them circulating. Sources of funds for the loans that were made to Credit with Education clients had to come from the assets of the institution and the credit union had to have enough liquid assets generally resulting from savings deposits to be able to disburse loans. Since Credit with education clients came into the system as net borrowers (they borrowed more than they saved) the rest of the money was usually allocated from the net savers in the institution (people who deposited more htan they borrowed). Integrating Credit with Education into credit unions was not a problem as long as the loan/savings ratio was low. It could get a bit more problematic as competiton for funds increased between different loan products.

2. The product did help do two thing with many credit unions - it brough in some very dynamic new members who were very diligent in their repayment and it put money to work was that was being parked in bank accounts. After about six or seven years, the product got old and needed to be re-dynamized, particularly with the older groups - which is what CIF, FfH, DID, and others have been actively addressing over the last few years.

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***From**: cloupeda [mailto:cloupeda@freefromhunger.org]*
***Sent**: vendredi, 27. février 2004 21:11*

Thanks Didier !

Peter, just to add to Didier's point a couple of things :

- FECECAM has more savers members than borrowers which explains the low level of the ratio loan/savings (so is the case of most of the networks in West Africa). This enabled them to provide enough loan funds for the women solidarity groups. Even though those are current deposit (term deposits products are developing…), the number of savers make these funds flow relatively stable and available to use.

- About what elements to add to women group lending to continue ensuring near 100% repayment rate, the deterioration of the repayment rate (as the groups get old) due to the dynamics that you've mentioned (what Didier meant by "the product got old") are the challenge that Freedom from Hunger and the networks are facing (those mature in offering the service). This challenge includes adapting the service to these dynamics (product adaptation), adding new features to the existing product (different kind of savings), developing a new product, good client graduation and transition (to the credit unions services) management. FCPB with the Financial Innovation Center (Burkina-Faso) has been addressing those issues over the last few years and one could see the positive impact on the repayment rate. No rocket-science, all depends on the field and accurate assessment of the situation (market research and client satisfaction monitoring).

Regarding the data about credit with education with the credit union networks in West Africa, unfortunately I am not in the office today, let me hopefully pass something to you next week.

Christian.