

Welthungerhilfe, Sparkasse KölnBonn, Bank Code: 370 501 98, Account No: 1115

Deutsche Welthungerhilfe e.V., Friedrich-Ebert-Straße 1, D-53173 Bonn, Tel. +49 (0)228 2288-0, Fax +49 (0)228 2288-333, www.welthungerhilfe.de



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ORIENTATION FRAMEWORK

MICROFINANCE

Guidelines for Welthungerhilfe projects

IMPRINT

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Deutsche Welthungerhilfe e.V.
Friedrich-Ebert-Straße 1
D-53173 Bonn
Tel. +49 (0)228 2288-0
Fax +49 (0)228 2288-333
info@welthungerhilfe.de
www.welthungerhilfe.de

Responsible for contents and coordination:

Dr. Heinz Peters, Rural Development Expert

Editorial staff:

Dr. Heinz Peters, Tobias Beck, Prof. em. Dr. Hans Seibel

Production:

Carsten Blum

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PREFACE

The attention given to microfinance systems in line with discussions on development policies has grown enormously and continuously during the last twenty years – attention that culminated in the 2006 Nobel peace prize awarded to development economist Prof. M. Yunus for his achievements in the area of microcredits. The global expansion of microfinance services will continue to grow in future years.

Financial services already play an important part in many development projects supported by Welthungerhilfe. The importance is likely to grow in the future, with increasing innovations in the areas of money transfers, insurance, savings activities or social security. We are committed to enabling access to these areas for the poor in our partner countries by initiating and promoting the respective innovations as part of our project activities.

This orientation framework has been prepared on the basis of a series of evaluations and studies, as well as on the experience gained from our project work. A particularly important factor has been the scientific assistance provided by microfinance expert Prof. em. Dr. Hans Seibel – University of Cologne.

While this orientation framework is not meant to cover the many facets of the financial system with the respective country-specific legislation and special features (please see the Internet pages listed in the Annex), it nevertheless provides readers with a condensed look at this complex issue. The objective of this orientation framework is to establish a conceptual framework and define the relevant reference points, to ensure that our contribution regarding microfinance services for our projects is effective for our target groups.

While microcredits were previously regarded as the solution per se for fighting poverty, its contribution must be assessed much more realistically today. An increasing number of studies highlight the excesses and distortions in this fast growing sector, and urge caution. In addition, we have also seen the continued growth of new financial services which go beyond the loan area, and which may also complement development measures in a meaningful way. In the medium term, we aim for the inclusion of our target group, the rural poor, in the regional economic flows and hence the money economy – an inclusion that is also indispensable for a sustained development process.

This orientation framework provides a practical tool for our employees in Germany, regional offices and projects, external experts who assess, plan and consult on projects, and our partner organisations in the respective countries. At the same time, it is also directed at Welthungerhilfe bodies and committees as an instrument to be used in their decisions regarding project support, and at the interested public which is thus informed about Welthungerhilfe's position and principles of work.

Mathias Mogge

Executive Director Programmes

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INTRODUCTION

1.1 Objective of orientation framework

This document replaces the 1998 Welthungerhilfe orientation framework on microfinance that conveyed the scientific principles of a sustainable microfinance system, which continue to be relevant at the technical-financial level. The document already highlighted the justified requirement for an organisational and personnel separation between the promotion of financial services and complementary aid and development measures.

This orientation framework aims to define Welthungerhilfe's position in the microfinance sector and derive the corresponding implementation recommendations for project work. To this end, it aims to support Welthungerhilfe employees and partner organisations with project conceptualisation and assessment activities.

The descriptive portions of the various aspects are designed to provide an overview of the microfinance sector in the development cooperation. The descriptive sections have been kept purposely short and general, since there is a wealth of easily accessible Internet websites with additional literature and knowledge references. A selection of this information, which can be used for a detailed examination of specific areas, has been attached in the form of an Annex.

The guidelines that have been derived are based on current Welthungerhilfe experience and focus areas. Since specific requirements can differ greatly at the various project locations, it is important that local analyses of special legal, economic and social framework conditions are observed accordingly. The innovation potential and knowledge gain related to the microfinance segment continue to be very high, so that a review of these guidelines at shorter intervals will be meaningful.

1.2 Background

The historical development of the microfinance sector in Europe provides important insights. For example, medieval German guilds already established insurance funds for sick craftsmen 500 years ago. The German communal savings banks, (since 1778) and cooperative institutes (since the 1846/47 year of hunger) are examples of the contribution made by savings and access to credit towards the successful fight against poverty and the development from informal to formal microfinance institutions (MFI), i.e. from social to economic business principles while maintaining socially responsible basic values. Today, they make up approximately half of all bank assets in Germany. While the starting conditions can only be compared to a limited extent, these examples can nevertheless serve as a reference for the future perspectives of the development potential of statutory and institutionally integrated local financial institutions in the partner countries.

Microfinance reached its peak in the 1990's. The first microfinance summit was held in Washington D.C. in 1997; microfinance institutions, their performance with regard to the fight against poverty and the demand for a global support of these institutions with capital transfers took front and centre at that time. 2005 was the UN year of microfinance, which increased the global popularity of this instrument of development support. The most successful MFIs have

access to a growing number of social and now also commercial international investment funds. In 2006, Grameen Bank in Bangladesh and its founder, Prof. Muhammad Yunus, received the Nobel Peace Prize, in an acknowledgement of the success of a broadly impacting financing model for loans to solidarity groups of poor women in rural areas in one of the poorest nations of the world.

Welthungerhilfe had been involved in the conceptual development of the self-help group approach on the basis of savings and loan activities in India since the end of the 1980's. Welthungerhilfe project support also contained a series of measures which were mainly related to revolving credit funds.

1.3 Definition

Microfinance is not really that different from the “normal“ financing system. The main difference lies in the target group that is addressed with this model. Microfinance services are generally directed at people with low purchasing power and available resources.

While the microfinance area started with a focus on providing loans, it has grown beyond the provision of microcredits for the poor, and now comprises all financial services for those segments of the population that do not have access to commercial banks or the formal financial system. Demand by the rural poor is mainly for collection and the safe storage of savings, supplemented by loans, insurance services and money transfers.

Special microfinance institutions (MFI), which were created in large numbers in recent years, offer the corresponding products. MFIs are specialised financial institutions which may differ significantly in size, social alignment and range of service offerings, and on the basis of the degree of formalisation. The MFI spectrum ranges from self-help groups and their amalgamations to cooperatives and microbanks and agricultural development banks. A series of MFIs has developed out of NGOs or continues to be part of an NGO; however, for the majority it has been noted that a specialisation and extensive separation from social support programmes is a meaningful development.

The regulative principles of the microfinance system based on the ideal of self-help comprise the following:

- Self-reliance through the mobilisation of local financial resources, particularly savings,
- viability through repayment of loans and ability to cover costs,
- sustainability through the generation of profits and a secure legal status, and
- outreach through access to financial services for all.

1.4 Importance of microfinance

The microcredit area has seen tremendous growth during the last twenty years, as credit volumes grew 110% per year between 1993 and 2009. In 2009, the world's largest one thousand MFIs serviced approximately 100 million borrowers and employed around 500,000 people.

In development aid policy, the microfinance area assumes an important position and is now considered part and parcel of such policies. Lack of access to financial services for the target group (the rural poor) is equivalent to exclusion from society. Accordingly, the integration of marginalised groups plays a key part in the development of special products which relate both to economic support as well as social security measures. For the rural poor, access to financial services provides not only a buffer against economic shocks but also "social inclusion", i.e. a direct strengthening of their social and societal recognition. Many examples provide evidence of the fact that this can make an important contribution towards the empowerment of women (approx. 65% of microfinance borrowers).

Since the target group of the rural poor has very little property, the microfinance system builds on solidarity and social pressure (mutual guarantees) – two criteria that have in the meantime also been recognised in the formal financial sector at the same level as collateral securities. Guarantees, group liability and cooperative services form the successful and mostly accepted basis of securing loans, the provision of services and the prevention of misuse.

Despite its undisputed successes, in recent years the microfinance and in particular the microcredit area have been subject to much more sober assessments with regard to their poverty-reducing effects. Microcredits are not a panacea for the sustained fight against poverty. Studies in India and Bangladesh have shown that a focus on the promotion of microcredits does not go far enough. There is a risk of a "debt trap" and even an increase in social inequality if other development-relevant areas (education, health, promotion of institutions, fight for rights, promotion of economic development, technology development) are neglected. The economic success of microcredits has led to an increased emergence of commercial actors as providers of such loans. While increasing competition lowers interest rates for borrowers, the sales orientation of lenders and lack of loan advisory services also increase the risk of defraudation of the rural poor who are often not well versed in financial matters. Therefore NGOs are increasingly asked to assess developments in this area with a more critical eye.

MICROFINANCE PRODUCTS

2.1 Savings

Saving is an important strategy for risk reduction, and an engine for economic growth. Savings represent consumption that is postponed for times of economic need, for balancing income imbalances, for later larger expenditures for investments or social concerns, for weddings, funerals or the education of children. The ability to save a certain amount of money is generally a prerequisite for obtaining approvals for larger investment loans by MFIs or banks.

Over decades, the mobilisation of private savings was the forgotten half of the rural financial sector in development support, many times justified with the reasoning that people were too poor to save. Studies and experience by Welthungerhilfe have repeatedly shown that it is exactly the poorer population segments that are forced to save in cash or kind and in fact have a high propensity to save if the framework conditions are in place. In this regard, the importance of long-term savings forms (e.g. Grameen Pension Scheme) for old-age provisions has also gained in significance. Savings in terms of physical items may include animals, agricultural products, gold and other valuable objects. Their disadvantage is uncertain liquidity, because such items must first be sold, as direct bartering transactions are often not possible. Where there are secure safekeeping options for savings, they are generally preferred, provided that there is stability with regard to the value of money.

In contrast to microcredits, development cooperation did not pay attention to savings for a long time. This neglect creates a very bad type of dependency for both customers and lenders. For example, a small farmer who is not able to deposit his income in a savings account following harvest time is again forced to take out a loan for the next sowing period, possibly at exorbitant interest rates, or must do without modern operating resources, with negative effects on productivity, income and risk protection. On the other side, lenders without a license for savings deposits are not able to mobilise local own resources. They remain dependent on government resources or international donors.

Subsistence agriculture and activities which generate very low profit will generally make it difficult to pay interests on loans. Therefore financial investments should come mainly or exclusively from savings (and additional contributions).

2.2 Loans

A microcredit is a small loan that must be repaid with interest within a certain time period. Where the ability to repay the loan is minimal, it may be very risky, i.e. access to credit is not without problems for poverty reduction. If loans are given to the right users and used appropriately (not only on a productive level), they may represent effective development instruments.

The promotion of microcredits is usually associated with a restriction that such funds can only be used for productive investments, in order to secure repayments from higher incomes.

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This means that loans for presumably non-productive purposes are taken on at significantly higher costs, making it more difficult to repay and, thus increase poverty. Self-help groups (SHG) and MFIs that are close to the target groups do not impose such restrictions, since they assume an integrated work and living sphere, and loans or accumulated savings offer another spectrum for satisfying basic needs. Such existence-securing loans frequently have considerable impacts on income. They maintain and expand the productive capacities of people and allow for an increase in the efficiency of their work performance. At the same time, the repayment capacity of lenders must also be taken into account, i.e. loan sums and repayment terms (terms and level of instalments) must be taken into account accordingly.

The cost-conscious design of interest rates plays a key role in the sustainability of the microcredit sector. Subsidies for interest rates and interest rate limits must be viewed as rather inimical to development in this regard. Subsidised loans send the wrong market signals. They can contribute to decapitalisation, rationing, fewer services and misallocations, make the mobilisation of savings more difficult and result in unwanted income transfers (so-called windfall gains).

As part of the microcredit system, loans are provided as group or individual loans. It has been shown that both loan forms can be designed in a cost-effective manner. Based on trends, group approaches are suited for starting with smaller loan sizes. In the longer term (with the differentiating economic development of group members), it has been shown that there is a requirement for individual loans with individual savings features, loan sizes and terms, in order to meet the different requirements of borrowers.

Microcredits also require customers to repay the loan under the defined terms, since there would otherwise be a risk of a “debt trap“ (repayments are financed with new loans). Where support measures are not able to prevent such a situation, other instruments (e.g. grants or material support) or supplementary measures should be considered. It is important to note that special groups (e.g. particularly vulnerable groups, single persons, migrant workers, the disabled) will require special support to obtain a level of adequate assistance. Repayments of loans may be at risk if the loan recipients

- live in sparsely populated areas resulting in high logistical costs,
- are dependent on minimally diversified economic activities (e.g. cultivation of only one cereal type, lack of commercial activities),
- mainly operate on a barter system, with low productivity,
- work in unstable weather conditions (as is frequently the case in agriculture),
- encounter unfavourable framework conditions in their national environment – hyperinflation, lack of legal security (e.g. post-conflict situations) or legal regulations that hinder the sustainability of MFIs (e.g. interest rate limits); agree to loan durations that are not reflective of how the loan is used – agricultural producers will generally require medium- and long-term loans for investments, whereas shorter terms are sufficient for loans related to agricultural inputs (repayment after harvest).

In the past, NGOs often provided their target groups with “revolving funds“ for loan provision. Experience in this field has been mostly negative¹, at least in areas where the NGOs assumed the management function. The situation is better for funds that are operated by the target groups themselves, and which are based on the latter's own savings deposits.

2.3 Insurance

Microinsurance as an instrument for development support has only garnered increasing attention during recent years. The importance of insurance services for the rural poor is increasingly recognised. This issue also has immediate relevance in view of climate change and the increasing number of risks created by weather fluctuations. The first international microinsurance fund (LeapFrog Investments) was issued in 2010. At the same time, given its innovative character, there is also a need for additional experience and room for developing the appropriate models.

Microinsurance is a useful tool for creating basic safety nets. This means that even poor people are able to protect themselves against serious life risks. Microinsurance targets groups that are active in the informal sector and do not have access to the formal financial and insurance system, or who are not able to afford the high insurance premiums. For these people, microinsurance mainly means protection against economic shocks and crises resulting from unforeseen illnesses, accidents or natural disasters.

An important criterion for microinsurance is low premiums, e.g. transactions costs must be kept to a minimum. This can be achieved, for example, with volunteer-based and self-help based designs or group insurance schemes. In addition, integration into value added chains can also result in cost-effective services. Starting points for the collection of insurance premiums may include both the receipt of production materials as well as the sale of products. Index-basing may be of interest to some risk areas, i.e. there is no individual claim assessment but rather an orientation to objectively measurable general criteria such as certain weather conditions (length of drought or amount of rain), whereby data collected by satellites may be useful.

The calculation of premiums and benefits is based on a realistic risk calculation (probability of occurrence and average claim amounts), which must however not be constant all the time. If conditions change (e.g. changed risk conditions due to climate change), premium levels or payout conditions may have to be adjusted to ensure sustainability.

Culture-specific designs are also useful in creating the required trust, whereby measures designed to prevent fraud must be considered.

A large number of customers and broadly distributed risk exposure is required to spread the risk – for example, health insurance does not work if only those people who are vulnerable to illnesses take out this type of insurance. Supra-regional cooperation and cooperation with larger insurance companies can create the required balance. For insurance systems to work in the long term, the basic legal and structural conditions must be in place. These include government financial market controls, including both regulatory as well as supportive controls, and communicative and social infrastructures (e.g. health insurance is based on the premise that access to doctors and health facilities is in place).

¹ See, e.g.:

<http://www.intercooperation.ch/finance/download/divers/reasons-failure-revolving-fund-eng.pdf>

<http://www.cgap.org/gm/document-1.9.2577/FN36.pdf>

The next years will call for the development of insurance models which benefit the target group of the rural poor with their risk management activities. NGOs and Welthungerhilfe can contribute towards this development. At the same time, there should also be an emphasis on separating economic requirements from social support, similar to the microcredit area.

2.4 Other financial services

In addition to the products outlined above, capital transfers also form another important pillar. Domestic and international money transfers represent an important source of income for many people in developing countries. Overall, the capital transfer system is suffering from the high costs associated with this process, as well as a very underdeveloped “distribution network“, particularly in Africa. African workers send more than USD 40 billion to their families every year, according to information provided by the UN. Approximately 40% of all transfers go to families in rural areas and often require recipients to undertake extensive travel to collect the funds. While most of the transfers are spent for daily consumption, studies have also shown that considerable sums are put to savings and long-term financial products (if offered), so that funds for investment purposes do in fact exist.

Other financial services are based on the technological progress or further development of existing products and are only slowly being accepted, even though demand is increasing and there are already a number of interesting examples. They include mobile or “branchless banking“ (innovative approaches based on account management by SMS), savings models (e.g. for old-age pensions or building loans), credit cards (to bridge periods of low income), leasing (for larger agricultural investments). In individual cases, it may be useful to consider the inclusion of such components as part of rural development projects, or to assess whether the framework conditions are in place.

PRINCIPLES OF WELTHUNGERHILFE PROJECT SUPPORT

3.1 Welthungerhilfe position

Given a design adapted to the location and target group, the promotion of financial services has a significant impact on poverty reduction and the sustainability of project interventions. In the short or at least medium term, development support aims to include the rural population in regional and national economic processes, and hence in the money economy. Welthungerhilfe is of the view that functioning financial services play an indispensable role in the economic integration of the rural poor, and to secure development success.

Welthungerhilfe considers microfinance services as an important component of its project work. Although microfinance alone cannot solve the structural causes of poverty, it can contribute to a sustained fight against poverty in line with comprehensive development processes. Thus, microfinance services are generally not supported in isolation. Studies have shown that there is no automatic effect between empowerment, poverty reduction and local economic development on the one hand, and the availability of microfinance services on the other hand. Other targeted measures are required to achieve social progress. An exclusive focus on the financial sustainability of microfinance systems could even have negative effects on the target group. What matters for Welthungerhilfe is that MFI places the focus on customers and the quality of services, e.g. that the survival of the MFI or non-sustainable economic interests do not take precedence over the well-being of the poor.

Welthungerhilfe is aware of a general conflict of roles between the activities of development-oriented NGOs and MFIs. NGOs view themselves mainly as advisory and assisting players that focus on supporting their target groups. MFIs on the other hand must act as a business whose existence is decided by the market and financial success. This also means that contract relationships with customers are clear and strict. In general, specialised organisations are better suited to providing sustainable financial services. Welthungerhilfe generally avoids supporting financial activities by non-specialised NGOs, or will only lend support if there is a clear focus on the establishment of a legally and structurally separate unit. Even if NGOs have clear weaknesses in “direct“ business matters, they play an important role in the promotion of economic activities as initiators, brokers and advisors. They secure the effective implementation of microfinance programmes, mainly by supporting the capacity development of target groups, and through supplementary social and economic support measures that strengthen the poverty-reducing impact of loans, insurance and other financial services.

3.2 Welthungerhilfe project support measures

The recommendation of a functional and structural separation also applies to Welthungerhilfe. The organisation does not intend to establish or operate MFIs on its own. Microfinance services should be provided to target groups by specialised and competent third parties (banks, MFIs, insurers etc.). At the same time it may be useful to initiate the formation and

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establishment of independent MFIs in regions without adequate financial infrastructure. Even if financial services are provided by specialised institutions, Welthungerhilfe plays an important part in the promotion of microfinance by facilitating relevant expertise, strengthening of self-help structures and training of target groups.

In the cooperation with the other members of the Alliance2015 network, Welthungerhilfe can draw on competent and specialized partners in microcredits. HIVOS, Concern and ACTED have set up specialist departments and developed support instruments appropriate to be applied in Welthungerhilfe's project work. In addition, Welthungerhilfe can count on the services of cooperation of potential partners with the necessary know-how in microfinance-related fields (e.g. insurance).

In respect to promoting microfinance Welthungerhilfe has good experience in supporting communities and self-help groups in developing the skills suitable to gain access to loans and other financial services. And while there is a need to consider adjusting support strategies and instruments to the respective socio-cultural framework conditions, it is, however, useful to draw back on the project experience of Welthungerhilfe and its partner organisations. For example, organisations in South Asia which offer training, advisory services and exposures can be contacted with regard to the establishment and development of microfinance self-help systems.

Support instruments used in Welthungerhilfe projects:

1. Development of capacities and skills by training of own staff, staff of partner organisations, and MFI personnel and members – i.e. training sessions and sharing of experience regarding the promotion of self-help groups, provision of training modules and exposure to model projects, as well as visits to successful organisations,
2. Support of the establishment of self-help structures (especially self-help groups based on savings and other financial activities),
3. Strengthening of financial skills of target groups (financial literacy),
4. Promotion of contacts to support organisations, MFIs and institutional banks (linkage banking),
5. Supplementary support with grants and advisory services for the productive and development-oriented use of funds (credit plus),
6. Support contacts with refinancing sources and facilitation of dialogue in the host country between the supported SHG / MFIs and their apex bodies with banks, MFIs and investment funds,
7. Promotion of innovation (possibly with start-up financing), especially with regard to financial services beyond credits, since there is still great need for model-building. Savings, credit cards or non-cash financial transfers can be integrated into food security programmes in a meaningful way. Microinsurance, also for the poor, in particular self-help based approaches, will be increasingly used as a meaningful instrument in risk prevention (i.e. direct social security beside other forms of risk management).

On the other hand, project support avoids the following:

1. Financing of (revolving) credit funds (or direct financial holdings in the MFI) in the hands of non-specialised NGOs or Welthungerhilfe itself (whereas investments in selected microfinance investment funds and endowment funds may very well be suitable and interesting investment opportunities for foundations),
2. Subsidies that go beyond start-up financing,
3. Issuing of loan guarantees as substitute for bank or MFI risk management,
4. Support of borrowers (SHG and individual persons) without own contributions (savings mobilisation and financial contributions),
5. Support of NGO financial services without clear organisational separation between financial activities and other economic and social tasks.

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MODELS AND SUPPORT APPROACHES

Differing development in Asia, Africa and Latin America has given rise to a large number of models and support approaches. Hence the approaches introduced below are only designed to provide an initial overview, which can be examined in more detail using additional literature.

4.1 Establishment and development of microfinance institutions

The expansion of microfinance as a part of the financial system in developing countries and emerging markets has been under way for some time, and has now reached a level of professionalism that is already leading to consolidation processes (growth and crowding out) in some countries (e.g. India, Tajikistan or Nigeria). The 2009 financial crisis has further exacerbated this trend. In essence, there are three inception models.

The upgrading of NGOs into professional microfinance institutions has been pursued particularly in Central and Latin America, as well as in Africa. Experience has shown that only a limited number of NGOs is interested in and able to take this direction as a result of their development policy goals. Examples of successful upgrading include the credit cooperatives Kafo Jiginew in Mali and the small loan foundation Haqiq in Tajikistan, which emerged from Welthungerhilfe projects, whereby Welthungerhilfe has since withdrawn from operating activities related to these projects. Another prominent example is Angkor Mikroheranhvatho Kampuchea, supported by Concern Worldwide in Cambodia.

In turn, we have also seen the inclusion of microfinance offerings by commercial banks (down-scaling) for population groups which did not previously have access to financial services. Downscaling presents a potential for considerable broad-based impact, but only a limited number of commercial banks are able and interested in pursuing this route. A prominent example of successful downscaling is the microsavings mobilisation undertaken by BAAC (Bank for Agriculture and Agricultural Cooperatives) in Thailand.

The new establishment of commercial microfinance institutions (greenfielding) has proven successful particularly in developing and transformation countries, where there is a lack of suitable financial service providers for lower income groups. This microfinance model requires considerable start-up investments in the organisational set-up and training of personnel. A typical feature of greenfielding is that donors maintain longterm capital holdings and also provide or finance initial management and advisory services. Frequently, there are no exit strategies, nor are they desired. A prominent example of greenfielding is the establishment of microbanks (“Pro Credit Banks”) by Pro Credit Holding AG from Germany. The professionalisation of this sector means that almost all MFIs now have access to financial resources and advisors which can address the respective requirements in accordance with the organisational form, culture and local conditions.

Alliance2015 partner HIVOS has developed a three-level support programme for micro-finance institutions. During the start phase, the MFI establishment is supported with additional contributions, followed by guarantees and deposits of the Triodos Bank during the development phase (Triodos has issued special investment funds for this purpose); once the break-even point is reached, the company is introduced into the capital market. The establishment of this programme (Financial Services and Enterprise Development) makes up approximately 15% of HIVOS' total project volume.

4.2 Linkage Banking

Linkage Banking refers to the linking of banks or MFIs with self-help groups (SHG). This model has proven to be very successful, particularly with reaching very poor target groups for whom access to financial services is related to empowerment and direct fight against poverty. A ground-breaking aspect in this regard has been the cooperation between Welthungerhilfe and the Indian partner organisation MYRADA (www.myrada.org). Pursuant to the approach that was developed, which is based on the savings and loan activities by (mainly) women's self-help groups, the Indian government established a programme with the objective of linking at least one million self-help groups to the formal banking sector. Key items for loan approvals by the banks include a SHG rating (systematic assessment of the SHG's capacity and performance based on a standardised questionnaire) and the awarding of group credits which are then distributed within the group. This requires the SHG to have skills related to financial management (accounting, interest rate calculation, taking of minutes, auditing), which are communicated by the NGO with training modules. Similar models can also be used in rural areas in other countries. NGOs can play an important role in improving the effectiveness of the SHG and the broad-based impact of the approach through accompanying training measures in other sectors.

4.3 Grameen Bank vs. self-help groups

Grameen Bank was founded in 1983 by Muhammad Yunus, who was later awarded the Nobel Peace Prize. This microfinance credit institution provides microcredits to people without income security in Bangladesh, and does so without requiring conventional securities but rather on the basis of group pressure and guarantees, thus attempting to reduce poverty.

The Grameen model was developed in Bangladesh and has been refined in the years since. The central "Grameen Bank" works with local MFIs. This approach is based on mutual guarantee. To this end, five persons form a guarantee group. Five to seven such groups in turn can be found in "Centres", which work closely with the local MFIs. Each member has his or her own savings and loan account. The tasks of the groups and centres comprise:

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- regular meetings conducted by an MFI employee who records the meeting, collects savings and repayments and pays out loans,
- the maintenance of a group savings fund which can be used by the group for specific purposes – in general this requires the approval of the MFI that maintains the account,
- a credit guarantee based on an agreement of group liability, the establishment of a group emergency fund and agreement that no group member will receive a new loan if another member is in arrears,
- the mutual examination of credit applications for reassurance that individual members provide regular savings contributions and loan repayments.

Recognised members are also owners of the bank, 94% of shares in Grameen Bank are held by members, of which 95% are women, while the rest is held by the Bangladesh government.

Grameen Bank also attempts to contribute to the social-cultural development of its members. The objective is to “educate” borrowers to be disciplined and responsible, for example through the promotion of behaviours, e.g. to maintain one’s own house, consider family planning, make sure children attend school, improve hygienic conditions (latrines, clean wells) and pay attention to balanced nutrition. At the same time, this approach focuses primarily on loans and savings.

The system of self-help groups exists in addition to the above approach. SHGs are groups of 15 to 20 members who work together on a voluntary basis.

The process of formal linking, e.g. starting business relationships with an MFI or bank, is usually carried out as part of a process that can take a few months or several years:

- Initially, its primary focus is on savings. SHG members decide on regular savings contributions,
- members receive individual loans from the resources they have saved. The purpose, modalities and interest rates are set by the groups themselves,
- the SHG opens a savings account in the name of the group in order to invest unused funds and possibly to qualify for a loan from the MFI or the bank,
- the MFI or the bank provides the SHG with a loan, which is then used by the group for internal loan provision.

The SHGs do not always follow all of the stages outlined above, and may also undertake interim steps. The SHG approach differs from the Grameen system in that the social aspects of group members take on greater importance (group concerns exceed mere financial management). Also the financial management in an SHG is more strongly characterised by own decisions. SHGs act similarly to “micro banks“, which perform their own financial services. NGOs only support management and the organisation of the autonomous groups. There are a series of design forms for these two basic models. Both models are successful,

whereby the SHG approach opens up more opportunities with regard to development. However, they do not represent a one-size-fits-all recipe – that is, each model must be examined in accordance with the socio-cultural framework conditions and designed accordingly.

4.4 Savings and loan associations

SHGs are based on the principle of „joint savings“. They represent a further development of two basic forms: Rotating Savings and Credit Associations (RoSCA) and Accumulating Savings and Credit Associations (ASCA).

An RoSCA is a group that has made a commitment to generate savings for a specific time period. Each member contributes funds at regular intervals (e.g. monthly), and members take turns in receiving the whole sum as a loan. Each member therefore receives a greater sum during an RoSCA cycle. There is no specified purpose. This savings method is a popular alternative as compared to the risk of keeping savings at home, where family and relatives may demand access to the savings. Each transaction is witnessed by all members at each meeting. Since the group does not generally hold any funds, this model features a very transparent and simple structure. In addition, risks are also limited due to the time limits (usually not more than six months).

ASCAs are time-limited informal microfinance arrangements. However, in contrast to RoSCAs, members elect a representative who manages an internal fund. Following a previously defined time period (usually six to twelve months), all loans are recalled and the fund (plus interest) is redistributed among the members.

Development cooperation attempts to tie such groups to the formal financial system were only successful in a few cases (Care International had some successes with standardised ASCAs in Africa). Success is closely linked with the source of financing. Where loans are financed through governments and international donors, projects have been consistently unsuccessful. Where loans are mainly financed through the savings deposits of members, hence with no or only moderate external financing, sustainability is relatively high, and can develop into a SHG with access to formal loans.

4.5 Microfinance Plus

Microfinance Plus stands for an approach that combines financial services with additional support measures (non-financial services). This approach has garnered increasing attention during the last five years, and highlights the significance of the microfinance system with regard to its impact on the fight against poverty.

Scientific evaluations regarding the impact of microfinance have confirmed that on its own, this instrument does not necessarily create a sustained positive effect in terms of the fight against poverty. Rather, it requires complementary support to achieve the targeted support of people. For example, in order to reach the poor population segments, loans are provided in combination with other support measures:

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- Investment advice, improvement of business skills and entrepreneurship development,
- promotion of health and preventative measures (health care services),
- basic literacy, education,
- social empowerment,
- job-qualifying measures (vocational training),
- nutritional counselling.

These result in a large number of possible combinations. For example, Alliance2015 partner Concern Worldwide works with the MFI Fonkoze in Haiti (www.fonkoze.org). Fonkoze is a part of a World Bank programme for particularly poor population segments, and combines the provision of loans with health services for women.

The combination of microfinance and social security systems is currently resulting in innovative and effective models with different experiences as to the nature of the cooperation between the NGO and MFIs/banks (partner approach, integrated approach, parallel approach). These combinations provide synergetic opportunities for the special expertise of NGOs.

4.6 Group-based insurance

As to the direct protection against risk for the poor experience has been gained in the following areas:

- Health insurance,
- Old-age provisions,
- Life insurance,
- Building insurance,
- Animal insurance,
- Harvest insurance,
- Credit (Life) insurance.

Four different options regarding the structure of microinsurance systems have emerged:

4.6.1 The community model

This type of insurance builds on existing self-help structures. Solidarity group members guarantee for each other by providing financial support to the relevant members when they take on risks. Sometimes the groups work with providers of health services to negotiate better terms of potential benefits for members.

4.6.2 The cooperative model

Savings and credit associations, or also MFIs, are responsible for product development, customer support and assessments of entitlement. In particular, this model is often used for insuring borrowers for the event of a death. In the case of an accident, the outstanding repayment amount is fully or partially assumed by the lender, eliminating the burden on the family of the deceased. In the meantime, NGOs and professional associations are also offering similar insurance products.

4.6.3 The partner-agent model

An established insurance company (partner) cooperates with a local organisation of the target group (agent), which is familiar with the requirements of the people and may already be active in the microfinance sector. This institutional option is particularly suitable if the target group organisation has very little experience with microfinance and microinsurance, because the partner is able to buffer the risks to a certain degree. Large insurance companies such as Münchener Rück, AXA or Allianz are becoming increasingly active in this type of microinsurance model.

4.6.4 The provider model

With this model, insurers offer services (especially health care) directly to groups or individual persons. The most commonly encountered insurers of this type include hospitals and doctors' associations which then treat the insured directly.

4.7 Branchless (Mobile) Banking

The establishment of a financial system in developing countries is characterised by considerable costs for the providers of financial services as well as the respective clients. This is partly due to the population density (long distances) and the labour-intensive advisory services which are provided, and also the low financial volume available to the rural population.

In order to address these framework conditions and to improve the efficiency of the financial sector, the microfinance system is increasingly testing new technological options. Branchless or mobile banking refers to banking without branch offices and relies on the following instruments:

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- Money transfers can be made via remittance slips (by post), on-line (Internet banking) or using mobile phones (telephone banking). In this context, electronic transaction receipts are used to identify clients (Kenya),
- agents for financial services, such as post offices or smaller sellers, can perform certain functions such as cash transactions and customer identification on location (Brazil),
- increasing numbers of ATMs (Automatic Telling Machines) in rural areas can be used to make withdrawals and deposits.

In particular, the wireless market will also be opening new distribution channels, since wireless services are already achieving coverage rates of approx. 80% in developing countries. This creates enormous cost savings and improves the distribution of microfinance.

4.8 Credit cards

Particularly poor target groups frequently face irregular income situations resulting from agricultural production cycles and seasonal employment. Therefore this group benefits greatly from access to credit to bridge financial bottlenecks.

As part of the reconstruction efforts after the tsunami catastrophe of 2005, the Indian partner organisation PAD (People's Action for Development) introduced a credit card system in the Tamil Nadu project region. The "Family Security Card" system is based on the conventional credit card system. Each family is allowed to purchase goods and services at local retailers for up to EUR 20 (equivalent), without paying cash. The administration of interest-free loans (card issue, checking of dealer receivables, settlement of invoices, negotiations with retailers) is the responsibility of the self-help groups. Credit cards enable marginalised families in particular to obtain sufficient goods and services on credit in the case of illness, loss of income or other emergencies. This instrument reduces the dependency on money lenders and promotes the perception of poor women as participants in the village's economy system.

CHECKLIST FOR MICROINSURANCE PROJECTS

The following questions should be considered during an initial review of the possible implementation of microinsurance approaches:

- Are the economic framework conditions sufficiently stable?
- Is there a minimum level of political stability?
- Is the legal situation clear and supportive?
- Does the innovation reduce the vulnerability of low-income households?
- Does the target group recognise the risks and necessity of the insurance?
- Is the principle of the insurance (risk pooling, solidarity) known and accepted?
- Is the number of insured persons adequate?
- Are the policy holders able (and willing) to make contributions on a regular basis?
- Are the terms and benefits aligned to living circumstances?
- Is the required management know-how in place?
- Does the provider (or own organisation) enjoy an adequate level of trust?
- Are there reinsurance possibilities?
- Is there information regarding the average amount of a claim and the probability of occurrence for the insured risks?
- How are unjustified benefit claims avoided?
- How can transaction and administration costs be kept at a low level?
- Is it possible to invest reserves securely and profitably?

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CGAP PRINCIPLES FOR FUNDERS OF MICROFINANCE

The Consultancy Group to Assist the Poor (CGAP - a consortium consisting of 29 (2004) public and private member donors working in microfinance) has defined the following key principles for development organisations and donors (CGAP, Pink Book 2004):

1. Poor people need a variety of financial services, not just loans. In addition to credit, they want savings, insurance, and money transfer services.
2. Microfinance is a powerful tool to fight poverty. Poor households use financial services to raise income, build their assets, and cushion themselves against external shocks.
3. Microfinance means building financial systems that serve the poor. Microfinance will reach its full potential only if it is integrated into a country's mainstream financial system.
4. Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people. Unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from donors and governments.
5. Microfinance is about building permanent local financial institutions that can attract domestic deposits, recycle them into loans, and provide other financial services.
6. Microcredit is not always the answer. Other kinds of support may work better for people who are so destitute that they are without income or means of repayment.
7. Interest rate ceilings hurt poor people by making it harder for them to get credit. Making many small loans costs more than making a few large ones. Interest rate ceilings prevent microfinance institutions from covering their costs, and thereby choke off the supply of credit for poor people.
8. The job of government is to enable financial services, not to provide them directly. Governments can almost never do a good job of lending, but they can set a supporting policy environment.
9. Donor funds should complement private capital, not compete with it. Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop support infrastructure, and support experimental services and products.
10. The key bottleneck is the shortage of strong institutions and managers. Donors should focus their support on building capacity.
11. Social and financial impact assessment in line with systematic reporting form an important part of successful microfinance programmes.

INFORMATION SOURCES

General information pages with additional literature:

- **Consultive Group to Assist the Poor:** www.cgap.org
- **CGAP documentation centre:** www.microfinancegateway.org
- **CGAP instruments:** www.microfinancegateway.org/resource_centers/technology
- **CGAP Resource Centers:** www.microfinancegateway.org/section/resourcecenters
- **MIX – Microfinance Information eXchange** MFI reporting: www.themix.org
- **Planet Rating** MFI analyses: www.planetrating.com
- **ADB – Asian Development Bank:** www.adb.org/Documents/Policies/Microfinance/default.asp
- **FAO:** www.fao.org/ag/ags/subjects/en/ruralfinance/index.html
- **FAO Rural Finance Learning Center:** www.ruralfinance.org
- **ILO:** www.ilo.org/public/english/employment/finance/index.html

Financing and funds:

- **Mix Market:** Platform with global information about MFIs, public and private funds that invest in MF, MFI networks, rating agencies and external evaluators, consulting firms and government agencies

Information on competent MF funds, e.g.:

- **OIKO Credit:** www.oikocredit.org
- **Triodos Bank:** www.triodos.com
- **Grameen Bank:** www.grameen-info.org
- **Brac:** www.brac.net

Microfinance Plus:

- **Seep** Study on microfinance Plus:
www.communities.seepnetwork.org/edexchange/node/313
- **Freedom from Hunger** innovative organisation for the implementation of MF Plus:
www.freedomfromhunger.org
- **Freedom from Hunger** Experience in MF Plus:
www.ffhtechnical.org/resources/microfinance-health

Gender and Microfinance:

- **Linda Mayoux:** www.genfinance.info

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Additional information on microinsurance:

- **Micro Insurance Academy:** www.microinsuranceacademy.org
- **Micro Insurance Network:** www.microinsurancenetwork.org
- **Micro Insurance Centre:** www.microinsurancecentre.org
- **Access to Insurance Initiative:** www.access-to-insurance.org
- **Münchener Rück Stiftung:** www.microinsurancecompendium.org

Competent Welthungerhilfe partners for microfinance and SHG support include:

- **Myrada:** www.myrada.org
- **OUTREACH:** www.outreachindia.org
- **Apmas:** www.apmas.org
- **Sa-Dhan:** www.sa-dhan.net
- **Bina Swadaya:** www.binaswadaya.org
- **Alliance2015-Partner:** www.alliance2015.org
- **Concern:** www.concern.net
- **HIVOS:** www.hivos.nl, triodus.com
- **ACTED:** www.oxusnetwork.org

