Micro-Financing Report and Recommendations

Prepared by Dacia Douhaibi for Vulnerable Children Society

INTRODUCTION

Microfinance initiatives (MFIs) address more than just material concerns; they can also address issues associated with "non-material" poverty, which includes social and psychological effects that prevent people from realizing their potential. A steady income, a savings account, training, and the discipline to honor loan repayments usually raise the self-esteem and status of clients.

Microfinance plays a critical role in achieving the Millennium Development Goals (MDGs) and enhancing development effectiveness by contributing to:

- poverty reduction,
- increased political, social, and economic development,
- social empowerment,
- community participation,
- school attendance of children, and
- Economic prosperity (especially for women).

BEST PRACTICES

An array of approaches have been used to create MFIs in Africa, ranging from traditional kinship networks and Revolving Savings and Credit Associations (ROSCAs) to NGOs and development projects.[1] Projects are funded by both the informal and formal financial sectors, as well as domestic and international donors. Each initiative must adjust to the specific cultural, political, and economic setting in which it operates, because each project is context specific. Microfinance best practices, as have been established through evaluating project outcomes in Africa, and allowing for diversity, include:

- Pool together people's resources through group organizing
- Rely and build upon what people know – tradition
- Reinforce microfinance to empower the African private sector
- Strive for efficiency

Principle One: Create community based projects

Collective and cooperative support is a critical microfinance strategy at the local level. Collective organization has several advantages in microfinance initiatives, the foremost that they pool together human and material resources. In Africa, group organizing has proven itself an effective strategy for MFI sustainability that Africans are especially predisposed due to traditional financial schemes, so communities

[1] A successful African MFI that has these characteristics is the Amhara Credit and Savings Institution (ACSI) in Ethiopia (288,000 clients).

are readily adaptable to new microfinance initiatives. This is particularly true in rural areas. Community based projects need:

- regular meetings to reinforce group solidarity, discipline, and consistent repayments. Groups are especially effective for educating and training microfinance participants, enhancing networking and information dissemination. They are also an important participatory tool that can reduce administrative cost by giving certain responsibilities, such as loan monitoring, to the members themselves.
- small group size. It is more effective to ensure that members genuinely know and trust each other.
- group members to take ownership for and support microfinance initiatives. Mutual trust and peer pressure within savings and credit groups ensure participation and repayment in microcredit programmes. The support and strength of a group often raises community consciousness and creates a common infrastructure to solve problems common to all, pooling local knowledge and resources for initiatives, such as bulk purchasing and transportation, collective bargaining, and common infrastructure development – i.e. water pumps, health care, and education schemes. Groups empower individuals to support each other not just financially, but also emotionally. The group impresses upon members that they are not alone or helpless, but can rely upon the support of their community, and cultivate self-esteem through contributing to each other. This non-material benefit is an important resource, especially during individual or collective crisis.

Principle Two: Utilize tradition

Microfinance initiatives that recognize and build upon local knowledge and tradition are more culturally compatible and hence sustainable with the local community. People feel more familiar and comfortable with concepts that borrow from their own tradition; this, in turn, improves MFI acceptance and outreach. Microfinance approaches rooted in local culture are also more participatory because clients are more ready to identify with and thus participate in the financial decisions and actions shaping their lives. As a result people become more invested in and committed to the sustainability of the microfinance initiatives, assume ownership and responsibility for their development, and become more self-reliant.

Principle Three: Reinforce micro-finance to support the private sector

Microfinance and microenterprise are critically linked; microenterprise development is an essential extension of microfinance schemes. If microfinance is to have a sustainable impact on poverty eradication, it must eventually scale-up into creating a private sector of entrepreneurs who function in the formal economy. In other words, microfinance has the potential of formalizing the informal sector, empowering micro-entrepreneurs to participate and benefit from the formal economy.

This potential, however, is contingent upon a supportive environment at all level and among all actors, supporting business incubation and expansion. For example, at the local level, regulation and standards among MFIs and their respective microenterprises can lend legitimacy to these initiatives, while networking among MFIs can provide a lobby platform to propel enterprises stemming from microfinance into the formal economy. MFIs can work together to ensure that Governments and donors do not support organizations that undermine the market for microfinance services and microenterprises by subsidizing loans.

Principle Four: Prioritize Operational Efficiency

If MFIs are to have a sustainable impact on poverty eradication, they must be efficient, financially viable institutions that can develop the financial leverage to expand outreach at a sustainable level. Adequate attention must be given to business practices to make MFIs financially sustainable in a reasonable timeframe. Key principles of operational efficiency for microfinance initiatives that have been identified are:

- Target the poorest
- Mobilize savings: Savings services strengthen institutional self-sufficiency and build a sense of discipline and accomplishment. When funds are internally generated rather than borrowed from or granted by external sources, MFI members become more invested and participatory in the prudential administration of savings towards credit and other MFI services.
- Charge interest rates that help cover operational costs: Interest rates should sustain the MFI operation.
- Market research: Preliminary and ongoing research is an important investment for microfinance initiatives. Research of the target population, geographic scope, and the local economy are vital to propose financial products and services that complement these realities.
- Streamline operations: Lean, simple infrastructures utilizing basic design of microfinance products increases operational efficiency. Simple and clear savings and loans criteria based on traditional mechanisms are also easily understandable by local people.
- Utilize volunteer staff in forming the committee or board: Voluntary staff and profit sharing from revenues are effective strategies for reducing operational costs. Training can promote the transfer of otherwise costly administrative responsibilities to volunteer staff. This empowers people to be more self-reliant and take initiative in their development. Volunteer staff are also typically intimately familiar with the area serviced, offering valuable knowledge and commitment.
- Target women: In Africa, women are a better credit-risk than men and more responsible managers of meager resources. Furthermore, they are more committed to using their loans for the benefit of their household rather than self-gratifying consumption. The most compelling reason to prioritize women is to assist the poorest, who are disproportionately women.
- Develop monitoring and assessment tools: Credible and reliable mechanisms to monitor and evaluate MFI operations improve overall efficiency and effectiveness. Reliable monitoring also fosters accountability.
- Invest in training: Well-trained staff/management cultivates a sense of ownership and investment in the MFI mission that transfers to the client base, creating client loyalty. Financial and business training in savings and credit utilization, basic management, bookkeeping, and marketing ensure that clients effectively invest microfinance funds into productive income-generating initiatives.
- Utilize pre-existing support organizations: Utilize pre-existing support organizations and establish linkages with other NGO networks and international groups.[2]
- Avoid external dependency: Donor funding can play an essential role in the start-up of a microfinance initiative, but MFIs need to become self-sufficient. Self-reliant MFIs are better able to maintain their identity, autonomy, and mission.
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[2] For example, The African Village Academy (AVA) is an Ethiopian NGO that supports self-sustaining development activities that stress participatory involvement. In its Savings and Credit for Enterprise Development program (SCED), a seven step training methodology is used.
Step one: introduces various types of financial institutions and tools.
Step two: participants discuss and examine themselves and their markets to identify potential microenterprise activities, which they then research individually.
Step three: participants discuss in detail their market findings (i.e. material, transportation, and market costs), and then are asked to form groups of typically four to five people.
Step four: elaborates the purpose of group formation in creating support and collateral for individuals, as well as developing specific business plans and budget planning.
Step five: participants meet each other's groups in units of up to ten groups, and discuss specific credit arrangements and requirements of SCED.
Step six: group members present their basic plans for final approval of the unit.
Step seven: all steps are reviewed to reinforce understanding of the program.

Traditional Financial Cooperatives in Ethiopia

Traditional cooperatives associations existed in Ethiopian society centuries ago in the form of *idir* and *iqub.*

Idir

An association of people that have the objective of providing social and economic insurance for the members in the events of death, accident, damages to property, among others.

Iqub

An association of people having common objectives of mobilizing resources - particularly financial - and distributing it to members on rotating basis. Iqub is very popular both in the rural and urban areas. It is also broadly practiced by people of all socio-economic positions in society.

- Has saving and credit aspect, involves borrowing and lending activity where by all members borrow from each other for varying periods of time
- The main rationale joining such association is the commitment for saving large sum of money in cash for future investment, beginning or expanding a small business or large outlay such as school fee, house repair, buying furniture etc.
- A certain amount of money agreed upon by the members of an iqub will be contributed by each member and an individual member is entitled to his turn, the order of which is decided by secret ballot, to receive the entire amount pooled
- Traditionally the initiator or treasurer of the iqub is the first to receive the money
- Iqubs vary in size of members and amount of capital contributed but serve people with various socio-economic status
- An iqub is cash based and requires strong mutual trust between members
- There is normally a sort of constitution which governs the operation of each iqub designed by its members
- Membership in Iqub can be held as collateral to borrow from individuals outside the group
- Bigger Iqubs - with higher capital - have a more business oriented operation, formalized institutions, written-by-laws, some transaction costs and still maintain cultural appropriateness elements; such as, mutual assistance in times of difficulties
- Iqubs are usually formed based on membership – usually formed based on pre-established social ties, same work place or same trade, neighbourhood, ethnic background etc.
- In bigger Iqubs involving higher capital people wanting to join require testimony of 2-6 of existing members to ensure their credit worthiness and act as guarantors for them

In some part of Addis Ababa *Iqub* collectors are becoming more professional and organized. They use computerized methods of tracking and registering members, give a passbook for daily, weekly or monthly contributions and deduct a certain percentage from each drawn amount for their service. Mostly, they administer many *iqubs* of varying share amount simultaneously. Such kind of *iqub* mostly exists in big open markets like 'Mercato' area or in a down town where many business shops are clustered together.
keeping cash at home is still the preferred way of saving and joining *iqub* is the second.

* One important consideration for *iqubs* is the frequent fluctuation of the birr is the fact that the value of the input/output may change drastically over the course of a period of months or year. For example, if each individual received $300 and there are 15 people in the *iqub*, there may be a large discrepancy in value between the first and fifteenth person.

Ethiopia’s Approach

The Ministry of Finance and Economic Development in Ethiopia suggests, in their Sustainable Development and Poverty Reduction Program that:

Owing to the economic situation and high population growth in urban areas, unemployment is increasingly growing. Therefore, to alleviate this problem, the following strategic actions will be taken:

- Design and implement extensively employment generation public works program through cash-for-work or food-for-work.
- Provide vocational and skill-training programs that enable to promote self-employment and job creation.
- Promote Micro finance institutions in urban centers. Facilitate access to working capital by promoting the establishment of community-managed savings, and credit comparatives, micro finance institutions and community support mechanisms such as “idir” and “iqub”

This report also indicated that Ethiopia has suffered from frequent disasters such as drought, famine, epidemics, flood, landslides, earthquakes, civil war, and mass displacement, as well as external shocks (for example, rapid declines in commodity prices). Urban households were found to be more vulnerable than rural households, perhaps because rural households have access to assets such as land and livestock. The major ex post risk coping mechanism of rural people is the sale of animal products and other agricultural outputs and loan from relatives, while urban peoples' main ex post coping instrument is reserve savings and loans from relatives.

Recommendations for Vulnerable Children Society

Given the traditional structures that already operate well on their own, through historically established and successful strategies, it is recommended that VCS do not work within the *iqub* system, but rather initiate its own small scale micro-finance project. Initiating a micro-finance structure that is close to that used by the *iqub* however, will help to ensure that it is familiar to community members. This should help aid in its success.

Further, in consideration of where our funding might be best used, it is recommended that it is directed towards the provision of the first pocket of funds that can be used as loans, and that funds be used for training of the board for the micro-finance project. The goal, however, will be for the project to become self-sustainable and not require the injection of outside funds to operate. Whether applicants need to "buy in" to the MFP in order to access funds is something that can be discussed.

The following are suggested parameters for this micro-finance project, based on the best practices derived from other organizations:

1. We begin with one localized project in Adama.
2. Management of the MFP will include a volunteer board made of community members and the local VCS staff person. Board meetings to review funding applications, receipt of repayment, etc. should occur on a monthly basis.
3. Board members should receive training in savings and credit utilization, basic management, bookkeeping, and marketing, as well as incorporate time for reflection on changes in market trends and the formal economy during board meetings to ensure proposed projects do not fall outside these guidelines.
4. Training in the areas described above should also be available to community members that are applying for funds. Whether there is a mandatory session for applicants is something that can be discussed. The structure of such sessions could mimic that of the African Village Academy presented in the best practices document.
5. Funding is distributed on quarterly basis. The local community board will make recommendations on who should receive funds each quarter and submit them to the VCS board of directors for final approval during board meetings.
6. The MFP should disproportionately target women.

Sources

Information for these best practices was drawn from the following documents in addition to communication with development workers:

- "Microfinance in Africa: Combining the Best Practices of Traditional and Modern Microfinance Approaches towards Poverty Eradication." Retrieved from: http://www.un.org/esa/africa/microfinanceinafrica.pdf.
- African Development Bank. "Micro-finance Policy and Strategy for the Bank Group." Retrieved from: http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/10000014-EN-MICROFINANCE-POLICY-AND-STRATEGY-FOR-THE-BANK-GROUP.PDF.
- IMF Working Paper. African Department. "Microfinance in Africa: Experience and Lessons from Selected African Countries." http://www.microfinancegateway.org/gm/document-1.9.29786/21470_wp04174.pdf.