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Developing Financial Institutions for the Poor and Reducing Barriers to Access for Women

Sharon L. Holt and
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Sharon L. Holt and
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ABSTRACT

Poor people, and especially poor women, commonly have limited access to financial services. So donors and governments have invested substantially in developing financial services for them. Most of these efforts have been large-scale, formal regulated programs that have emphasized providing subsidized credit to poor farmers. Experience has shown that they have largely failed. The main underlying premise of these programs was that market interest rates were too high and made credit inaccessible to the poor.

The dismal experience with regulated, subsidized programs offered clear lessons. One is that distortionary macroeconomic and regulatory environments hinder financial sector development and do not improve poor people's access to credit. Another is that subsidized credit, without incentives, markets and infrastructure, is likely to remain debt as borrowers have limited options for profitable investments. So there has been a shift away from subsidized credit toward alternative financial services programs for poor people.

These more recent programs are based on different premises. Instead of focusing on reducing interest rates, they have addressed other barriers to access to financial services for the poor. These barriers include, for example, high transaction costs for lenders and borrowers, insurmountable collateral requirements, and low levels of literacy and numeracy among the poor that constrain their access to formal sector loans. These financial institutions have been informal and quasiformal.

Informal financiers include family and friends -- who provide most of the loans to the poor, professional moneylenders and pawnbrokers, tradespeople, money collectors, and saving and loan associations. Informal finance has many advantages. Informal financial agents, for example, know their clients better than formal banks do, which reduces information costs; and their interest rates reflect market forces. But despite their popularity and potential, most forms of informal finance have limitations. They are segmented from larger markets, which curtails lender's access to funds and reduces competition, and have limited ability to provide term finance or mobilize savings. Also, as long as the poor rely on informal markets they may remain outside the economic mainstream.

Quasiformal alternatives may give greater scope for expansion. Over the last 10 to 15 years a number of successful quasiformal programs, such as the Grameen Bank in Bangladesh, ADEMI in the Dominican Republic and the Badan Kredit Kecamatan (BKK) in Indonesia, have provided poor people access to financial services. These institutions vary in size, ownership and organization, but fall into broad categories -- innovative commercial banks, financial intermediaries, parallel programs, and poverty-oriented development banks. They have improved poor people's access to financial services while maintaining financial discipline. Most programs, for example, do not heavily subsidize interest rates and do link repayment to future lending. The main characteristics of successful financial services delivery models include: reducing transaction costs; charging commercial interest rates; establishing deposit facilities; targeting poor clients; developing skills and institutions, and emphasizing finance more than business training.

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Abbreviations and Acronyms

ADEMI -	Association for the Development of Microenterprise, Dominican Republic
AFC -	Agricultural Finance Corporation, Zimbabwe
BKK -	Badan Kredit Kecamatan, Indonesia
BRAC -	Bangladesh Rural Advancement Committee
BRI -	Bank Rakyat Indonesia
CAMCCUL -	Cameroon Cooperative Credit & Union League
FED -	Fundacion Ecuatoriana de Desarrollo, Ecuador
FHH -	Female Headed Households
PCRW -	Production Credit for Rural Women, Nepal
SEWA -	Self-Employed Women's Association, India
SFDP -	Small Farmer's Development Program, Nepal
SSA -	Sub-Saharan Africa
USAID -	United States Agency for International Development
WWF -	Working Women's Forum, Madras, India

Note: Unless specified, all dollar figures are in U.S. dollars.

EXECUTIVE SUMMARY

This paper is an extension of background work for the 1990 World Development Report on poverty. The WDR argues for policies and public investments that promote the productive use of labor, the most important asset of the poor. It concludes that targeted programs are no substitute for policies that encourage broad-based development growth but that they can be an effective way to reach the poor -- and that expanding poor people's access to financial services can improve their ability to participate in economic growth and accumulate assets.

Poor people, especially poor women, commonly have limited access to financial services. So donors and national governments have invested substantially in developing financial services for the poor. Most efforts have been large-scale, formal, regulated programs emphasizing more rural credit to poor farmers -- usually at below-market interest rates. The underlying premise of these programs has been that market interest rates are too high and that reducing them would make credit more accessible to poor people.

The dismal experience with regulated, subsidized credit offers clear policy lessons to donors and governments. First, regulated and subsidized credit tends to go to those with wealth and influence. It does not reach the poor or mobilize savings and it weakens financial sectors and institutions. The World Bank and other donors have already begun working with governments to remove distortions in the financial sector -- for example, by liberalizing interest rates and lifting regulations that make it illegal for institutions to charge different interest rates to different customers. A viable financial sector that is not undermined by subsidized interest rates and other forms of regulation is probably the best way to help the poor make the best use of public investments.

Second, credit by itself cannot generate income. Without adequate incentives, markets and infrastructure, credit is likely to remain debt -- as borrowers have limited options to make profitable investments. If the objective is to help the poor benefit from economic opportunities, public funds may be better invested ensuring that the poor have access to basic infrastructure -- such as roads and irrigation -- and basic services, such as agricultural extension and market information.

Barriers to Credit and Savings for the Poor

Reforming the financial sector will strengthen and expand it but that may not automatically give poor people, especially poor women, more access to financial services. Sometimes the barriers to formal credit are deeper than interest rates or physical access to banking facilities.

Why is access to financial services limited for the poor? One problem is misperceptions about their credit and savings behavior. Data on poor people's behavior with credit and savings are scarce, but examples from recent experience counter the myths that poor people use financial services exclusively for short-term consumption, that poor people do not save, and that women are poor credit risks. For lenders who have ignored deposits from poor people, or who have been concerned about repayment rates, it is important news that the poor can be financially sound borrowers and savers.

High transaction costs are a major barrier for both lenders and borrowers -- on the lenders' side, the high unit costs of administering small loans, and on the borrowers' side, the incidental and opportunity costs of dealing with a bank. Regulated interest rates deter credit to poor people because rationed credit tends to go to those who are better off -- and know the system. Poor people -- women in particular -- do not meet collateral requirements, and the valuables to which women may have access may be accepted as collateral by moneylenders and pawnbrokers but not by formal institutions. Poor people's low levels of literacy and numeracy and their unfamiliarity with formal banking make it difficult for them to overcome the procedural barriers of taking out a formal loan. In many cases, it is culturally inappropriate for women to travel alone the distances necessary to secure formal credit, and women do not belong to most organizations through which important contacts -- sources of credit or information -- may be made.

The nature of women's businesses also affects their access to credit. First, because women have limited access to resources, their businesses tend to be small and have low profit margins, which makes them bigger credit risks. Second, they tend to keep their businesses close to home to minimize conflict between their many roles -- as wage earner, mother and homemaker. Third, women agriculturalists tend to produce relatively low-return food crops -- while men specialize in cash crops.

For the most part, traditional, subsidized credit programs have overlooked the most significant obstacles to credit for the poor -- high transaction costs and collateral requirements -- and have failed to take into account the special nature of women's businesses.

Developing Financial Institutions for the Poor

Measures that increase poor people's access to financial services generally focus on developing either informal or quasiformal financial alternatives -- or both.

Informal Finance

Family and friends provide most loans to poor people. Other traditional informal sources of credit and deposit facilities for the poor are professional moneylenders and pawnbrokers, tradespeople, money collectors and moneykeepers, and associations -- including credit associations.

One form of informal finance used heavily by low-income women is the rotating savings and credit association (ROSCA). These associations, found worldwide under many names, provide savings-based credit. Their popularity among low- and middle-income groups demonstrates poor people's propensity to save. Classic ROSCAs, whose members know each other, are established by an organizer who oversees meetings. Members contribute a mutually acceptable amount of money to a fund that is then accessible to them on a rotating basis. Some clubs have developed a welfare system -- a special loan fund that is lent out or given as grant to needy members.

In Ghana, ROSCAs -- or "susus" as they are called there -- have evolved into larger-scale credit and savings facilities. Money collectors visit markets daily to accept deposits, no matter how small -- mainly from market women. A susu collector can handle the accounts of as many as 800 to 1,000 people in a market area. Monthly deposits can reach thousands of dollars.

Informal finance offers many advantages. The informal or indigenous financial agents know their clients better than formal banks do, which reduces their information costs; their administrative and staff overhead is lower; their interest rates are not regulated so they can adjust to market forces; and they are not subject to reserve requirements. But despite their popularity and potential, most forms of informal finance have their limits, too. They are isolated from larger markets, which curtails lenders' access to funds and reduces competition. They also have limited ability to provide term finance and large loans, or to mobilize savings. (ROSCAs and money collectors do emphasize savings but rarely pay interest.) So informal finance has trouble coping with inflation. And it has been argued that as long as poor people, particularly women, rely on informal markets they will remain outside the economic mainstream.

Some of these limits could be reduced by forging links between informal and formal finance. Working with ROSCAs may be particularly desirable as they incorporate savings and credit and seem to be effective in reaching women. There is still much to be learned about the nature and feasibility of such links, however -- and in many areas where formal financial systems are highly centralized and corrupt, it may be unwise to link them to indigenous schemes. Donors and governments could support research and experimentation in forging links between informal and formal systems, but care should be taken not to weaken well-functioning informal markets because of weakness in the formal sector. Some argue that the best way to help ROSCAs might be to leave them alone. Whatever links are forged, local control and equity interests should be retained.

Donors and governments can try to replicate successful informal systems or to disseminate information about them. Grassroots organizations -- nongovernment organizations or government extension programs -- can teach poor people who are unfamiliar with informal programs such as ROSCAs how these savings clubs operate. Such programs can be especially helpful to groups with little chance of getting access to credit or more formal schemes. In Ghana, for example, the Africa 2000 initiative -- supported by the Canadian International Development Agency -- is successfully disseminating the ROSCA message to villagers unfamiliar with this type of savings club. Ghana's Money

Back program -- a government-established insurance program based on the indigenous informal susu scheme -- demonstrates how a successful informal model can be copied in a formal market. Money Back provides life insurance and investment opportunities mainly to small and medium-scale businesses. As with the susu, clients determine how much to deposit based on a scheme worked out with the corporation, and collectors visit markets daily to collect contributions. Money Back operates on a familiar model, gives clients a secure place for their savings, and allows the corporation to mobilize money that would otherwise have been kept largely out of the formal banking system.

Countries can make their financial programs more attractive to low-income clients by experimenting with such approaches. It can be difficult for organizations that do not have a local presence to conduct training or disseminate information locally -- but organizations such as the World Bank can certainly assist local organizations that are well-suited to do so.

Quasiformal Alternatives

A variety of quasiformal innovative institutions have developed in the last 10 to 15 years to provide financial services to poor people. These institutions vary in size, ownership, and organization but fall into certain broad categories:

* Innovative commercial banks have developed specialized financial programs (such as the KUPEDDES and SIMPEDES programs of the government-owned Bank Rakyat in Indonesia, BRI) that experiment with ways to combine commercial and social banking objectives.

* Financial intermediaries -- commonly nongovernment organizations (NGOs) such as Women's World Banking or government agencies -- "retail" the credit from banks to small borrowers. They also provide training, referrals, help with loan applications, and guarantees to lenders that reduce transaction costs to both borrowers and lenders.

* Parallel programs are institutions (usually NGOs) set up to provide financial services to the poor outside the formal financial sector. Examples are ADEMI in the Dominican republic; the Working Women's Forum in Madras, India; PRODEM in Ecuador; the Saving Development Foundation in Zimbabwe; and the Cameroon Cooperative Credit Union League (CAMCCUL).

* Poverty-oriented development banks offer a limited range of financial services, and intermediate socially in ways traditional banks would not. Some parallel programs have evolved into large-scale poverty-focused banks with access to central or commercial bank funds. These institutions are officially registered as banks but focus on development and poor people -- which distinguishes them from commercial banks. The Grameen Bank in Bangladesh, for example, organizes its members into groups and presses for social development, in addition to providing financial services. Using this model, the Grameen Bank has reached more than 800,000 people, mostly women. The large-scale Badan Kredit Kecamatan (BKK) in Indonesia, which reached about 2.7 million people in 1982, does not organize groups but does work with local

mayors, or luras, to get references and identify poorer members of the community.

Lending to poor people, especially poor women, is more difficult for some institutions than others. Financial expertise is only part of a successful operation. Also needed is some form of social intermediation or understanding that allows the financial institution to meet the needs of a diverse low-income clientele. Institutions such as the Grameen Bank successfully combine grassroots development and financial services, but this may not be a viable option for many institutions. Commercial banks operating in a competitive banking market must rely on more standard operating procedures (such as collateral) and may thus be less able to adapt to local needs. One country may need several types of private and quasigovernmental organizations operating at different levels to meet the needs of small-scale savers and borrowers.

Successful Delivery Models

What are the chief characteristics of successful financial services delivery models? Successful programs improve poor people's access to financial services while maintaining financial discipline. Most programs, for example, do not heavily subsidize their interest rates and do link repayment to future lending. Successful programs also share common features that are modified to meet local needs. Those features include:

* Reducing transaction costs for both borrowers and lenders (often by establishing joint-liability, borrower-solidarity groups to reduce risks and transaction costs). Using this approach the Grameen Bank in Bangladesh has achieved loan recovery rates exceeding 98 percent. Joint liability schemes may be especially important for women with little access to traditional forms of collateral.

* Charging commercial interest rates that allow financial institutions to cover costs -- the 23-percent average real interest rate charged by a sample of USAID's microenterprise programs is illustrative of a rate that covers costs. These rates are lower than what poor clients might pay a moneylender, but high enough to diminish the credit's attractiveness to elites.

* Establishing deposit facilities in which savings are secure and accessible and yield a good return. In many programs, savings are mandatory. At BKK, for example, borrowers are required to save 3.3 percent of the face value of the loan every month, which helps capitalize the loan funds and insure against default and helps borrowers accumulate assets.

* Targeting poor clients -- not poor sectors. Quasiformal initiatives target poor clients directly and to a lesser extent the economic activities in which they are occupied. To do so effectively requires research, which takes time and money.

* Developing skills and institutions that teach poor people how to use a bank account or fill out an application form and provide financial institutions with the necessary training.

* Emphasizing credit more than business training in lending to microenterprises. The history of training and technical assistance for the business development of microfirms is largely a story of failure. Business training may eventually be helpful, but not without more research and experimentation.

Implications for Policymakers

Quasiformal programs offer the greatest scope for policy action for donors and governments. The question is, are subsidies necessary? If they are, what should be subsidized and for how long? And what criteria should be used to evaluate performance?

Subsidies may be called for in developing quasiformal financial institutions for poor people because of the high startup costs for training (of staff and clients), forming groups, and research and experimentation. What is not clear is how long these subsidies should last. For programs with a credit orientation, subsidies should be withdrawn as costs decline and financial self-sufficiency should be a central goal. But for programs that emphasize training or technical assistance, subsidies may be longer term. Clear guidelines on how to evaluate these subsidies must be developed.

Interest rates should not be subsidized. Rather, subsidies should finance administration, training, and institution building -- the management-intensive parts of project design, implementation, and supervision. These activities can be time-consuming for donors and government agencies, but may be allotted proportionately little of the program's subsidies. Support is also needed for research. New financial institutions that serve poor people must investigate prospective clients to assess their needs and develop a service delivery model suitable for local circumstances.

More general research is also needed. Topics that need exploring include whether small and microentrepreneurs need business training (and what kind) and what priority to assign credit for small and microentrepreneurs in demand-constrained economies.

Well-designed and implemented financial services programs can help people increase their productivity and income. And these programs can be an effective way to reach poor women, who are typically left out of traditional credit schemes. Both donors and governments have a role to play in helping these institutions develop. But credit should not be viewed as a panacea for reducing poverty as it is not appropriate everywhere and for everyone. And it is only a small part of the much larger policy changes and investments needed to foster the economic growth that reduces poverty -- and the economic opportunities that poor people need to improve their own lives.

INTRODUCTION

This paper reviews experience with financial services programs for poor people, especially poor women -- who face more severe (and sometimes different) obstacles to such services than men. First, it summarizes lessons learned from experience with largely ineffective -- even harmful -- formal, regulated credit initiatives. Next it identifies the key characteristics of recent credit and savings programs that have tried alternative approaches and have successfully developed financial services for the poor.

It is an extension of background work for the 1990 World Development Report on poverty. The 1990 WDR emphasizes the crucial role of policies that promote the productive use of labor, the most important asset of the poor. It argues for policies and public investments that stimulate rural development and create jobs in urban areas. The WDR concludes that targeted programs are no substitute for policies that encourage the broad-based development growth that reduces poverty, but that they can be an effective way to reach the poor. Appropriately designed schemes to expand the poor's access to financial services can improve their ability to participate in economic growth and accumulate assets.

The research for this paper drew on many sources, not only on World Bank projects. The Bank has been heavily involved in credit programs (rural credit operations accounted for close to a quarter of the Bank's agricultural lending between 1982 and 1988), but it has relatively limited operational experience with financial services programs targeted to poor people.

The paper is organized in five parts. First, it provides background on the types of lending programs designed to reach poor people. Second, it discusses poor people's use of and access to savings facilities and credit -- and credit's potential and limits as a tool for reducing poverty. Third, it analyzes the largely dismal experience with traditional, subsidized credit programs. Fourth, it describes alternative approaches to expanding financial services to the poor, especially women -- and identifies the main characteristics of successful, informal and quasiformal credit and savings programs. The final section presents conclusions and discusses the paper's implications for policy makers.

1. BACKGROUND

Poor people, especially women, commonly have limited access to financial services so donors and national governments have invested substantially in developing financial services for the poor. Most of these efforts have been large-scale, formal, regulated programs emphasizing more rural credit to poor farmers, usually at below-market interest rates. The underlying premise of these programs has been that market interest rates are too high and that reducing them would make credit more accessible to poor people. But regulated credit rarely reaches its target group and such credit programs can damage financial systems. The failure of regulated credit has led to a reevaluation of the role of credit in poverty reduction and in development generally.

The experience with regulated credit taught valuable lessons. One is that distortionary macroeconomic and regulatory environments hinder development of the financial sector and do not improve the poor's access to credit. Another is that subsidized, targeted credit cannot reduce poverty without adequate markets and infrastructure. So there has been a shift away from subsidized credit toward developing a new generation of financial services programs for poor people.

These programs emphasize developing financial institutions to meet the credit and savings needs of poor people -- mainly small and microentrepreneurs. Some of these efforts -- such as the Grameen Bank in Bangladesh and Badan Kredit Kecamatan (BKK) in Indonesia -- have succeeded notably in giving poor people a gateway to more productive and lucrative self-employment -- without compromising financial sectors. Their clientele include disadvantaged groups, especially poor women, that are almost always excluded from traditional credit projects. The contrasting experiences of these first and second generation projects suggest that credit alone cannot reduce poverty, but that well-designed and implemented savings and credit schemes can be effective instruments of poverty reduction.

2. BARRIERS TO CREDIT AND SAVINGS FOR POOR PEOPLE

COMMON MISPERCEPTIONS ABOUT POOR PEOPLE

Lack of data prevents systematic, crossnational analysis of the way poor people use credit. But enough information exists to disprove some myths about poor people's uses of credit, ability to save and repayment behavior.

One common perception is that borrowers use loans for consumption rather than production. Lenders are especially concerned about this, because it may reduce the likelihood of repayment. But evidence from studies of low-income credit strongly suggests that -- except for the ultrapoor -- credit is commonly used for productive investment. Survey data from the Grameen Bank

credit program in Bangladesh show, for example, that client loans are used mainly for productive purposes.¹ Most funds went for productive uses for both male (95.1) and female (91.9) borrowers (see table 1).² A survey of informal lenders and borrowers in the Philippines revealed that 48 percent of small farmers did not use informal credit for consumption (Von Pischke 1989: 147-148). Experience with microenterprise programs in Latin America supports these findings (Placencia 1989).

Table 1: Patterns of Loan Use
By Gender of Borrower, 1985

Use	(Percent of Current Loan Amount)		
	Men	Women	All
Nonproductive	4.9	8.1	6.6
Consumption	0.5	0.9	0.7
Social ceremony	3.5	5.0	4.3
House repair	0.9	2.2	1.6
Productive ^a	95.1	91.9	93.5
Crop cultivation	7.4	5.5	6.4
Livestock raising	19.9	33.1	26.8
Poultry raising	3.9	5.7	4.9
Processing and manufacturing	11.6	18.3	15.1
Trading and shopkeeping	43.7	27.3	35.1
Transport and other services	8.7	2.1	5.2

a. Production figures do not add up exactly because of rounding.

SOURCE: Hossain 1988:50

Similarly, poor people's savings are not used exclusively for short-term consumption. Data on savings are even more scant than data on credit, but the few studies that have been done suggest that savings are used for long-term investment and welfare. In her study of savings patterns among low-

¹ Sample size: 975 borrowers.

² The fungibility of money makes it difficult to pinpoint exactly which dollars were spent where. In the Grameen example, borrowers could have used savings to purchase livestock and loans to finance a wedding. Also, borrowers may use the loan to meet immediate debt payment or consumption needs, yet still manage to organize the resources needed to invest in a productive activity that enables them to make timely repayments. As long as the household's financial management permits repayment, the actual use of the loan may not be important.

income women at a tea plantation in Cameroon, Delancey (1983: 141-145) found that low-income female wage earners used 45 percent of their savings for security and welfare (retirement or sickness), and 36 percent for investment and development -- especially for education. Consumption appeared to be a relatively low priority, accounting for only about 19 percent (see table 2).

Self-employed poor people also use their savings for productive investment. Studies of savings mechanisms in Ghana's informal sector found, for example, that small-scale traders and vendors rely heavily on indigenous money collectors to save working capital for their enterprises (Gabianu). Similarly, in a savings program in Zimbabwe, female farmers used their savings to purchase fertilizers and other farm inputs (Bratton 1990).

The main myths about poor people's savings, however, have focused less on its use than on its existence. The assumption has been that poor people, because they are poor, do not save -- so few programs have promoted deposit facilities. But there is evidence that the poor do save in informal financial markets and in other liquid and illiquid assets. They save to smooth consumption by building up stocks of grain seasonally, running them down when the harvest season is over. They also possess durable assets such as household tools, jewelry, and draftpower which can be sold in times of crisis (drought or flood) and then repurchased (Bell 1989: 23-24). And recent research indicates that given opportunities and incentives to save, poor people can save far more than previously thought (Adams and Graham 1984: 318; Otero 1989).

A Rural Savings Mobilization Project in the Dominican Republic, for example, clearly demonstrated the rural demand for deposit services (Gonzalez-Vega 1988: 1-5). Under this project, sponsored by the U.S. Agency for International Development (USAID), the Banco Agricola (BA), a public agricultural development bank with 31 branches scattered about the countryside, set up passbook savings account facilities. Pessimists doubted that low-income rural households would save, but the pilot project -- initiated in 7 branches -- grew rapidly. The number of term deposits rose from 2,628 in 7 branches in October 1984 to 66,570 accounts in 31 branches in 1987. Moreover, 40 percent of the depositors were new clients for the bank, who demanded only a safe and convenient means of managing their liquid assets.

This demand for savings has been documented in other regions. Since the introduction of the SIMPEDES program (the saving scheme associated with the Unit Desa system of the Bank Rakyat Indonesia, BRI), the Unit Desa's savings have grown faster than its lending. In 1989 savings exceeded loans. The savings program has also reached four times as many people as the credit program; in 1990 SIMPEDES had more than 6.7 million clients (Boomgard and Angel 1990; Rhyne 1990).

Table 2: Women's Reasons For Saving at Tole Tea Estate

Reason	Number	Percentage of reasons ^a (N=370)	Percentage of savers ^b (N=171)
Social security or welfare	170	44.9	--
Trouble or sickness	88	23.3	51.5
Transport home	6	1.6	3.5
Funeral	15	4.0	8.8
Unemployment or retirement	30	7.9	17.5
Future plans	6	1.6	3.5
Bequest to children	18	4.7	10.5
Family assistance	7	1.8	4.1
Investment or development	138	36.4	--
Education	89	23.5	52.0
Help children get employment	5	1.3	2.9
Help children get ahead	2	0.5	1.2
Business	6	1.6	3.5
Farm	1	0.3	0.6
Corn mill	3	0.8	1.8
Engine saw	2	0.5	1.2
Rental structure	3	0.8	1.8
Own house	20	5.3	11.7
Taxi	7	1.8	4.1
Consumption	71	18.8	
Food and clothes	18	4.7	10.5
Maintenance of children and self	23	6.1	13.5
Durable assets ^c	10	2.6	5.8
Durables and sewing machines ^d	(17)	(4.5)	(9)
Autos	4	1.1	2.3
Bridewealth	4	1.1	2.3
Enjoyment	4	1.1	2.3
Other	1	0.3	0.6

a. The number citing each reason as a percentage of the number of all reasons cited.

b. The percentage of savers giving each reason.

c. Bicycles, radios, pots and pans, iron beds.

d. Sewing machines purchased for personal use or investment.

SOURCE: Delancey 1983: 142-142

Another myth implicit in the few loans given to women in developing countries is that women are poor credit risks. But evidence from credit programs with heavy female participation have found this not to be true. In their study of women's credit in Bangladesh, Hossain and Afsar (1989: 25-27) found that programs that focus on women have higher repayment rates than traditional credit schemes that have excluded women. At the Grameen Bank -- which in 1988 boasted a 98-percent repayment rate and 84-percent female membership -- managers argue that they purposely target women borrowers because they are more disciplined and more careful with capital (Hossain and Afsar 1989: 49). Bank officials at the Rural Enterprise Fund in Peru share those sentiments (Arias 1984).

Two of the best savings and credit programs in India -- the Self-Employed Women's Association and the Working Women's Forum, both with 90 percent to 95 percent repayment rates -- are women's programs. More than 60 percent of the members of Indonesia's highly successful Badan Kredit Kecamatan program are women (USAID 1989: 33). And the Foundation for the Promotion and Development of Microenterprises (PRODEM) in Bolivia has more than 10,000 borrowers, 77 percent of whom are women. After almost 4 years of operation, repayment rates remain above 99 percent. The point here is not that women are better financial risks than men, but that they are at least as creditworthy.

These examples are not the same as detailed analyses of poor people's behavior with credit and savings, but they do counter the myths that poor people use financial services exclusively for short-term consumption and do not save, or that women are poor credit risks. For lenders concerned about repayment, or who have ignored deposits, these are important lessons. The poor can be financially sound borrowers and savers. Yet few funds from commercial financial markets find their way to the poor.

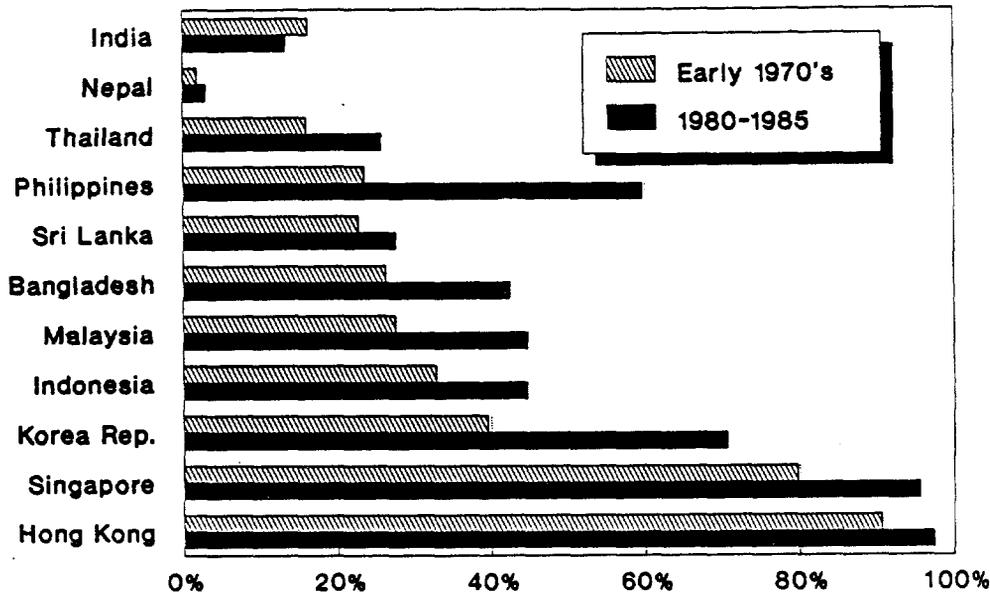
THE ROLE OF CREDIT IN POVERTY REDUCTION

This paper's interest in savings and credit goes beyond disproving myths. It is interested in how, or if, production credit and saving can contribute to income generation among poor people -- especially poor women. To gain greater insight into the potential use of credit and savings for poor people, the discussion below examines their income-generating activities, focusing mainly on women's activities.

Poor women are heavily concentrated in informal businesses, both as self-employed operators and as employees. Many of these businesses could benefit from improved access to credit. Studies indicate that women own or operate roughly one-third of all businesses in the informal sector, although participation rates vary across regions (Berger 1989:1021). Even in South Asia -- where official statistics portray women's participation in the labor force as relatively low -- women are an important part of the informal economy. A study of 26,583 poor pavement dwellers in Bombay, for example, found that 43 percent of women worked in the informal economy (SPARC 1986, cited in World Bank 1989a: 96). And women's employment in nonagricultural activities is growing in many areas, including the Asian countries (see figure 1).

Figure 1.

Female Employment Outside Agriculture Selected Asian Countries



Source: ILO, *Yearbook of Labour Statistics*, various issues.

It varies by country and region, but women's businesses are usually in commerce, services, and certain types of small-scale manufacturing -- for example, garments and other cottage industries. Among borrowers from a small-business loan program in Peru, 29 percent of the women were involved in commerce and 30 percent in sewing, compared with only 5 and 21 percent of the men, respectively (Berger 1989). A household survey in Bangladesh showed that 59 percent of women engaged in income-generating activities worked in cottage industries (reported in Hossain and Afsar 1989: 7). Women dominate the market and distribution systems in food and other trades in much of Sub-Saharan Africa (Berger 1989). In Eastern Yorubaland, in southwest Nigeria, for example, 95 percent of the traders in some commodities are women (MacGaffey: 4).

Improved access to financial services -- especially credit -- can help raise the productivity and incomes of small and microentrepreneurs. With insufficient working capital, small businesses must wait for proceeds to accumulate before they can purchase materials. This commonly results in inefficiency and discontinuities in products and sales. In addition, small businesses are seldom able to take advantage of quantity discounts on raw materials. Moreover, to obtain enough cash to meet daily living expenses, they must sell their goods immediately, whether market prices are favorable or

not (Lycette and White 1989). Access to credit could help alleviate these problems.

Women are also involved in agriculture and commonly need credit in the planting season. The United Nations estimates that women provide 60-80 percent of agricultural labor in Asia, and 40 percent in Latin America (Blumberg 1989). In Sub-Saharan Africa (SSA), women are responsible for about 70 percent of staple food production. In many areas women manage half of the farms -- in countries such as Zaire, 70 percent of farms (World Bank 1989c: 103). Women are also heavily concentrated in dairy and livestock production in regions such as South Asia. A household survey in Bangladesh revealed that 23 percent of the women who earned income raised livestock (Hosain and Afsar 1989: 7-9). A time allocation study of villagers in Gujarat, India, found that 19 percent of a woman's workday was spent in household dairy production (World Bank 1989a: 51-54).

As the percentage of households headed by women rises (half of all households in parts of SSA are now headed by women), women's income-generating activities become increasingly important -- and so does their need for credit and other financial services. A recent World Bank (1990a) study of population, agriculture, and the environment in SSA found that households headed by women not only lack male adult labor, but are also often underendowed in land, capital, farm equipment, and transport aids -- unlike households headed by men. This situation is aggravated by women's limited access to agricultural extension, credit, and other public services delivered through formal cooperatives.

But expanding credit alone will not reduce poverty and improve productivity and incomes. To be effective, financial markets and credit programs must be backed up by markets and infrastructure. And some poor groups are more likely to benefit from credit than others. Berger (1989) and Lipton (1989) argue that the "ultrapoor" are unlikely to be good candidates for loans because their subsistence position forces them to use whatever cash they have for consumption. The financial needs of very poor men and women may be best served by increasing their access to interest-bearing deposit accounts.

The ability of small-scale entrepreneurs to benefit from increased access to credit may also be limited under certain economic conditions. A study of Ghana's small enterprise sector under adjustment found, for example, that microenterprises are constrained more by a lack of demand than a lack of credit (credit is more important for small and medium-size firms). The study's authors conclude that credit and supply-side assistance may help individual microenterprises, but these inputs will do little to raise incomes in the microenterprise sector unless demand for the microentrepreneurs' products rises (Steel and Webster 1990). Studies from Latin America in the 1980s are less pessimistic about the benefits of credit to microenterprises in adjusting economies (Berger and Buvinic 1989). Credit needs differ between poor groups and in different economic environments. A careful analysis of local conditions and potential client needs must always precede project design.

DOCUMENTING AND EXPLAINING LIMITED ACCESS TO FINANCIAL SERVICES

Poor people have limited access to credit, and women typically have even less access. In Bangladesh, data gathered from 800 randomly selected households suggest that about 45 percent of respondents had access to credit in 1987 -- but only 2.8 percent of them were women (reported in Hossain and Afsar 1988).³ Data from the Indian government's Integrated Rural Development Programme (IRDP) show that female coverage rose by 5 percentage points over 1985/86, but only 15 percent of the beneficiaries were women in 1986/87 -- less than half of the 30-percent target. Outside of IRDP, the figures are even lower. An in-depth study of credit flows by gender in two bank branches in Andhra Pradesh found that disbursements to women ranged between 6 percent and 12 percent but dropped to zero for agricultural loans (World Bank 1989a: 134). These trends are not limited to South Asia. In the loan program of the Banco Industrial de Peru, directed at small and microbusinesses in the shanty towns of Lima, only 14 percent of its borrowers were women despite specific instructions to target women (Arias 1989: 208). In Zaire, only 1.5 percent of all commercial bank loans were allocated to women in 1984 (World Bank 1990d: 15-17).⁴

What factors explain poor people's limited access to financial services, and why are these constraints especially difficult for women? Evidence suggests factors of both supply and demand. On the supply side, high transaction costs and controlled interest rates generally inhibit poor people's access. High transaction costs are largely the result of the high unit costs of administering small loans to a highly dispersed and possibly illiterate clientele and the increased risks that arise because poor people lack collateral and a formal credit history. Few banks are set up to handle the additional constraints associated with small-scale lending.

These disincentives are exacerbated by government regulation of interest rates, which leads to the rationing of credit. Rationed credit, like other goods, tends to go to those with wealth and influence -- not poor people. Formal lenders have strong incentives to favor larger, more accessible clients.

On the demand side, poor people's access to formal credit has been constrained by collateral requirements, high borrower transaction costs, the limited education that makes application procedures difficult, social and cultural barriers, and the nature of their work. These constraints -- some of which are strictly gender-related -- are worse for women.

Collateral requirements. Many poor people do not have enough collateral to satisfy risk-averse lenders, but women have particular trouble

³ The sample was small, but the data suggest that women's access to formal credit is limited.

⁴ Poor people's lack of access to formal credit is documented more generally in the next section of the paper.

meeting this requirement. Property and other assets that can be used to meet collateral requirements are usually in a man's name. In South Asia, for example, laws and traditions severely impede women's ability to become titleholders of land and other assets (World Bank 1989a, 1989b, and 1989e). In India, no laws explicitly impede women's access to land but many states -- including Uttar Pradesh and Gujarat -- have statutes that prevent women from inheriting agricultural land.

In Sub-Saharan Africa traditional land rights that gave women the use of land owned by a close male relative are being replaced by land registration and land titlement schemes. Husbands are usually registered as sole owners. With no access to title or security of tenure, women's access to credit has been limited, which makes it harder for them to buy inputs (World Bank 1989c: 83). In many of these countries, even when women have the right to inherit land, they often lose it to male relatives.

And the types of valuables to which women do have access are often deemed unacceptable by formal financial institutions. This includes women's small-scale businesses that do not have the documentation of formally registered enterprises, and valuables such as jewelry that are often accepted by moneylenders and pawnbrokers but rarely by formal banks (Berger 1989: 1023).⁵

Transaction costs. The noninterest costs of acquiring formal loans can be substantial (Adams and Nehman 1979). Total borrowing costs, especially for small borrowers, may greatly exceed nominal interest payments (Adams and Graham 1984: 315; Christen 1989). These costs include transportation costs, bribes, legal and title fees, paperwork expenses, time lost waiting in line, and dealing with these demands. Borrowers' costs may also increase when formal loans are not disbursed quickly. Christen (1989: 16-19) argues that the losses microentrepreneurs incur in terms of forgone opportunities to purchase inputs or equipment under favorable conditions may represent the heaviest of borrower costs, heavier than interest and other noninterest costs.

Because of their multiple work obligations in the household and marketplace, women incur high opportunity costs for forgone labor (Berger 1989; Hossain and Afsar 1989). Poor women on average work longer hours than men of the same class when both household and market tasks are counted (King and Evenson 1983). So women who want access to credit can be easily discouraged by high transaction costs.

Limited education and familiarity with loan procedures. Poor people's relatively low levels of literacy and numeracy make it difficult for them to overcome even the procedural barriers of taking out a formal loan. In many countries women have less education than men, which puts them at a further disadvantage in applying for credit. In Africa, women's educational attainment averages 58 percent of men's; in the Middle East, 56 percent; and in South Asia, only 47 percent (Blumberg 1989: 62-63). Girls' school enrollment and literacy rates have increased greatly in Latin America, but

⁵ Commercial banks in Nepal, which will advance money for jewelry, are the exception.

literacy rates are still low for older women, who tend to work in the informal sector. In Guatemala and Honduras, literacy rates for women 35 years and older are only 30 and 37 percent, respectively (Lycette and White 1989: 28). As a result, many poor women have trouble completing the complicated application forms and financial statements that banks require. And their limited experience with formal credit institutions adds to the problem.

Social and cultural barriers. Social and cultural constraints may also restrict women's demand for, and access to, credit. In many areas it is considered inappropriate for a woman to travel alone the long distance between her rural home and a bank in a town, or to offer the occasionally necessary bribe to a male official in charge of credit applications (Lycette and White 1989: 29). More important, women are commonly excluded from local organizations, such as agricultural cooperatives or social groups, that provide information or may even extend credit. In Malawi, for example, credit is usually administered only to members of farmers' clubs. By custom, women may not belong to these clubs and membership is often on the recommendation of agricultural extension agents, whose contacts are mainly with men (Morna and others.)

The nature of women's businesses. The types of business women engage in also affect their access to credit. First, because women have limited access to physical and human resources, their businesses tend to be among the smallest, even within the category of microenterprises (five employees or fewer); and have low profit margins.⁶ Most women's businesses have only one worker -- the business owner herself. Women-owned businesses borrowing from a microenterprise program in Ecuador, for example, averaged only one employee, compared with two for men's businesses (Berger 1989). Their concentration in smaller, lower-profit activities makes women bigger credit risks for commercial lenders.

Second, women tend to keep their businesses close to home to minimize conflict between their many roles as wage earner, mother, homemaker, and so on (Berger 1989). These multiple responsibilities restrict the time and mobility of many women in developing countries (Hossain and Afsar 1989; Otero and Downing 1989). A crossregional study of women in the informal sector in Zimbabwe found that about 64 percent of women run their businesses from their homes (ENDA 1990: 18). Similarly, a study of a sample of women marketers in the Kutus region of Kenya showed that for the most part, women were limited to small-scale retail trade, unable to pursue long-distance wholesale trade because of constraints on both their time and mobility (Downing and Santer 1989).

One reason women agriculturalists commonly have difficulty getting access to credit is that women tend to produce relatively low-return foodcrops. Studies suggest that women produce most staple crops because they can combine that activity with preparing food for their families (Longhurst 1982; Watts 1984; and Chipande 1987). But women farmers do not limit their activities to subsistence crops. Not only do they sell part of their surplus,

⁶ References to "small businesses" will include small businesses and microenterprises.

they also produce minor cash crops to pay for other household necessities (World Bank, 1990a: 22-24).

3. THE PROBLEM WITH SUBSIDIZED CREDIT⁷

Many governments have intervened in financial markets to expand credit for the poor through large-scale subsidized credit programs. These efforts had been justified on several grounds, including the perceived inability of the poor to pay market interest rates; formal lenders' unwillingness to lend to the poor because they are high-risk; the belief that lenders could be forced to lend to the poor; and the perceived exploitive behavior of informal lenders (Adams and Graham 1984: 314). But, these perceptions have turned out to be unsubstantiated or only partially correct (see below). And these programs have for the most part overlooked the poor's most significant obstacles to credit -- high transaction costs and collateral requirements -- and have failed to take into account the special nature of women's businesses.

Subsidizing the nonpoor. Experience with more than 20 years of donor-supported, regulated, subsidized formal credit strongly suggests that this intervention has rarely achieved its stated objectives. Despite many efforts to channel credit to the poor, only 5 percent of farms in Africa and 15 percent of farms in Asia and Latin America have had access to formal credit (Braverman and Guasch 1984: 4). Subsidized credit has largely become a transfer to loan recipients, usually the nonpoor. In Brazil, for example, these yearly income transfers were estimated to be as high as \$3 billion to \$4 billion -- between 1.2 and 1.6 percent of gross domestic product (GDP) -- at their peak in the late 1970s and early 1980s (Sayad, 1979).

This inability to reach the poor has persisted despite forced government expansion of commercial and agricultural banks into rural areas. In Bangladesh, for example, the number of rural bank branches increased from 854 in 1975/76 to 3,225 in 1983/84. The amount of credit disbursed to these institutions increased from Tk 461 million to Tk 10,087 million in this period (Rahim 1985; Hossain 1985; cited in Hossain 1988: 21). But after more than a decade of subsidized credit in Bangladesh, only 15 percent of the smallholders and 7 percent of the landless households had access to institutional credit (World Bank 1989: 88-89). Data from Nepal are even more striking. The larger landholders captured so much more of the formal credit that small farmer's access to it actually declined. Between 1969/70 and 1976/77 the proportion of small farm families using formal credit dropped from 64 percent to 45 percent (1976/77 Agricultural Credit Review Survey of Nepal 1980, cited in Bennett 1990).

Even where subsidized credit has reached the poor, program viability and sustainability remain questionable. India's Integrated Rural Development

⁷ Considerable research has been done on the problems of subsidized credit. One of the most comprehensive books on issues in subsidized rural credit is Von Pische, Adams, and Donald, (1983).

Program, for example, covers more than 27 million rural families (Pulley 1989: 5). But low repayment rates (59 percent of IRDP loans were in arrears in 1984) and IRDP's inability to ensure the poor's continued access to credit, among other factors, suggest that IRDP has not succeeded in establishing sustainable financial services for the poor. A sample study in Uttar Pradesh revealed that even among households that had repaid their loans and retained their assets, only 7 percent received additional credit (Pulley 1989: 44, 47-48).

Damaging the financial sector. Artificially low interest rates and credit regulations also distort resource allocation, and often lead to political patronage or corruption in financial services. Wiggins and Rogally's (1989) study of credit cooperatives in Tamil Nadu describes how politically motivated loan waivers -- which began in the late 1970s and early 1980s -- undermined the credibility and finances of credit cooperatives. As recently as 1989, some states announced interest rate waivers for cooperative member farmers who repaid their overdue principal by a particular date.

In subsidized credit programs, typically a relatively high percentage of loans are overdue. Studies show that the proportion of loans in arrears ranges (with few exceptions) from 30 percent to 90 percent for formal subsidized credit programs in Africa, the Middle East, and Latin America (Braverman and Guasch 1989: 6). South and Southeast Asia report similar results. An in-depth study of three Indian villages suggests a correlation between low repayment rates and the availability of subsidized, institutional credit (Bhende 1986: A-121). In two of the three villages studied, where more than 65 percent of all credit is subsidized credit, more than 65 percent of loans are in arrears. By contrast, the third village -- which has little institutional credit -- has a much lower rate of arrears (17 percent). The same study shows that low repayment rates are higher among large farmers. High recovery rates in Japan, Korea, and Taiwan -- attributed to strong village cooperatives and incentive and enforcement systems -- are the exception (Braverman and Guasch 1989: 6). These programs also demonstrate that institutions are important to project success.

Subsidized interest rates also discourage savings. A sample study of the notoriously political Primary Agricultural Credit Societies, in India's Tamil Nadu state, for example, showed that deposits grew only 3.5 percent between 1980 and 1985, while advances -- excluding medium- and long-term credit and rephased loans -- doubled in volume. Low savings combined with a poor repayment record -- in March 1986, 43 percent of borrowers in the Madurai region were in default -- have weakened the financial sector (Wiggins and Rogaly, 1989: 224-230).

Undermining the rationale for subsidized interest rates. This rationale for providing credit at below-market rates is undermined by evidence that the poor are willing to pay market interest rates. A study of rural financial markets in Bangladesh, which experimented with lending at annual interest rates ranging from 12 percent to 36 percent, found that small farmers' demand for loans remained relatively inelastic up to an interest rate of about 30 percent (USAID 1983). Moreover, poor people borrow routinely on the informal market, where interest rates have historically exceeded formal market rates -

- although the gap has shrunk over time. Interest rates charged by noninstitutional lenders averaged about 40 percent a year in the 1950s and dropped to 30 percent a year in the 1970s (U Tun Wai 1977).

Even if banks charge unsubsidized interest, they still provide credit at a lower rate than the moneylenders. Short-term loans from the Thai Bank for Agriculture and Agricultural Cooperatives (BAAC), for example, have cut into the moneylenders' business at lending rates of 12 percent to 14 percent. This is not just because of their access to subsidized funds, however. If BAAC were to lend at the 20-percent market rate, it would still undercut private lenders (Siamwalla 1989).

Conclusions. Policies to direct credit to the poor through subsidies and regulation have largely failed. Rationed credit is captured by the better-off and weakens the financial sector. If the objective is to help the poor benefit from economic opportunities, public funds may be better invested ensuring that the poor have access to infrastructure, such as roads and irrigation, and services such as agricultural extension and market information. Without adequate markets and infrastructure, credit is likely to remain debt, as borrowers have limited options to make profitable investments. A viable financial sector that is not undermined by subsidized interest rates and other regulations may be the best way to help the poor make the best use of public investments.⁸

4. DEVELOPING FINANCIAL INSTITUTIONS FOR THE POOR

INFORMAL FINANCE

One option is to expand informal finance, the most common source of credit for the poor. Family and friends provide most loans to poor people; other informal financiers include professional moneylenders and pawnbrokers, tradespeople, money collectors and keepers, and associations of acquaintances (including credit associations).

The lower transaction costs of informal financial arrangements give them an advantage over formal lenders. Four characteristics give them this advantage: informal or indigenous financial agents know their clients better than formal banks, which reduces their information costs; their administrative and staff overhead is lower; their interest rates are not regulated so they can adjust to market forces; and they are not subject to reserve requirements (Bailey 1990:3). Informal lenders have their own costs, including segmentation from other markets, but informal markets can serve poor people's financial needs better than formal institutions can.

⁸ But even a perfectly flexible interest rate (reflecting the price of funds) does not ensure that the market will clear. As a commodity, credit has peculiar features that stem from the inherent uncertainty about repayment. If there is no means of ensuring complete repayment, the actions of both borrower and lender are influenced by the terms of their contract and the market will not operate (as a Walrasian auction market.)

Certain characteristics of informal financiers seem to appeal to poor people, especially women:

- * Low transaction costs for borrowers because of the lender's proximity.
- * The immediacy of disbursement.
- * The lender's willingness to extend small loans.
- * Flexible repayment schedules because the lender is familiar with the borrower's situation (Lycette and White 1989).

Informality does not mean these systems lack structure or financial viability. The bylaws of credit associations, for example, tend to be strict and commonly include fines for members who fail to fully cooperate or participate. Informal arrangements also meet key tests of financial performance by economizing on transaction costs, lengthening term structures, and managing risks effectively. The following examples of informal systems demonstrate how the systems combine financial discipline and flexibility.

Friends and relatives -- lenders and moneykeepers. With their access to formal institutions restricted, poor people, especially women, tend to rely heavily on family and friends for both emergencies and routine borrowing needs. Liedholm and Mead's (1987) multicountry survey found that more than 90 percent of small-business owner-operators got their initial capital from close friends and relatives. Repayment is not required until the borrower is in a position to return the loans (repayment schedules are flexible because the lender is familiar with the borrower's situation), and interest is seldom explicitly charged. Small loans are no problem, and are minimal and flexible, and borrowers are sometimes allowed to repay in different ways, such as working in the lender's fields. Relatives are usually nearby, so loans can easily be arranged and, perhaps most important, made available immediately (Lycette and White 1989: 30).

Relatives and friends can also be important for savings. For a study of savings in The Gambia, Shipton (1990: 19-23) found in a 1988 survey that 46 percent of women and 20 percent of men gave money to other individuals (mostly relatives) for safekeeping. Shipton found that most deposits were made in January and February, when groundnuts were harvested and marketed, then withdrawn in May and June, when the savings were needed for land preparation and planting. People relied on this "moneykeeper" system more for trustworthiness and safety than for proximity or convenience.

But relatives and friends are limited as sources of finance. They may have few resources to lend, do not usually pay interest on deposits, and do not help integrate poor people into the formal financial system. So they may keep poor people marginal, outside the economic mainstream.

Moneylenders and pawnbrokers. Like relatives and friends, moneylenders are familiar to the borrower, as they are usually local traders, merchants, or landowners. They make loans available with few or no collateral requirements

and are flexible about repayment. But they do often charge high rates of interest. In Latin America, it is common for local moneylenders to charge between 10 percent a month and 20 percent a day (Ashe 1984). Traditionally, these rates were believed to reflect the moneylenders' ability to charge monopoly rents, but studies have shown that these rates may reflect high risks and opportunity costs of capital.⁹ Despite high interest rates, low-income people tend to rely on moneylenders. Either their quick and flexible services are highly valued or their clients have few alternatives.

Pawnbrokers are especially attractive to poor women as they take jewelry, ornaments, or gold as collateral -- personal items that may be the only form of collateral available to women who do not have access to land titles or cattle. Like moneylenders, pawnbrokers provide small loans quickly and on flexible terms (Lycette and White 1989: 31). But these options have drawbacks. High informal rates pose a real problem for poor people and informal lenders rarely accept deposits or provide long-term loans.

Shopkeepers, wholesalers, large farmers, and intermediaries. These are particularly important sources of credit for poor people, especially women marketers, for meeting basic family needs and participating in the daily marketplace. Shopkeepers may extend credit to well-known, consistent buyers for food and other household requirements by maintaining a record of the purchases and allowing the bill to remain unpaid for some time. Interest is usually not explicitly charged; rather, it is implicitly charged through higher prices for goods (Lycette and White 1989). Wholesalers also allow clients to leave a bill unpaid until the purchased goods are sold at retail. Middlemen will sometimes advance credit to small and microentrepreneurs to buy raw materials and expect, in return, to buy their products at relatively low prices. Loans from large farmers usually take the form of inputs or crops, and interest is repaid in kind. In India, for example, larger farmers commonly lend one maund (about 42 kilograms) to small farmers and tenants which is then repaid at harvest with interest ranging from one-fourth to even one full maund (Rudra 1984). These informal schemes have the same kinds of weakness as financing by moneylenders and pawnbrokers.

Rotating savings and credit associations and money collectors. Another form of informal finance used heavily by low-income women is the rotating savings and credit association (ROSCA). These associations, found worldwide under many names (Geertz 1962; Ardener 1964; March and Taqqu 1986), provide savings-based credit. Their popularity among low- and middle-income groups demonstrates poor people's propensity to save. Classic ROSCAs, whose members know each other, are established by an organizer who oversees meetings. Members contribute a mutually acceptable amount of money to a fund that is then given to them on a rotating basis. Some clubs have even developed a welfare system -- a special loan fund that is lent out or given to needy members (Gabianu; Lycette and White 1989: 32).

⁹ See Von Pischke (1989: 141-152), for a thorough discussion of moneylenders.

In Ghana, ROSCAs -- or "susus" as they are called there -- have evolved into larger-scale credit and savings facilities. Daily contributions range from 10 to 500 cedis -- between \$0.04 and \$2.00. Money collectors visit markets daily to accept deposits, no matter how small -- mainly from market women. In rural areas, collectors make their rounds early in the morning before farmers go to their fields and in the evening after they come back. A susu collector can handle the accounts of as many as 800 to 1,000 people in a market area. Monthly deposits reach millions of cedis. In Tamale, in Ghana's northern region, an average collector collects monthly deposits of 1.5 to 2 million cedis (\$6000 to \$8000) -- a sizable amount when you consider that the average amount of savings held by a typical Northern bank is roughly \$40,000 (Interdisziplinare Projekt Consult 1988: 98).

But ROSCAs and susu money collector schemes have drawbacks. ROSCAs have difficulty meeting members' needs when loans are synchronized as they are, for example, at the beginning of agricultural production cycles. Nor do they typically pay interest. Moneycollector systems are also susceptible to security problems -- and when collectors run off with deposits, clients have little recourse.

Problems and prospects of informal finance. Despite their popularity and potential, most forms of informal finance have limitations. Financially, they are isolated from larger markets, which curtails lenders' access to funds and reduces competition. They also have limited ability to provide term finance and large loans or to mobilize savings. (The ROSCAs' and moneycollectors' emphasis on savings is the exception -- and even they rarely pay interest.) So informal finance has difficulty coping with inflation (Bailey 1990). And it has been argued that as long as poor people, particularly women, depend on informal markets they will remain outside the economic mainstream (Berger 1989).

Some of these limitations could be reduced by forging links between informal and formal finance. Working with ROSCAs may be particularly desirable as they incorporate savings and credit and appear to be effective in reaching women. But there is still much to learn about the nature and feasibility of such links. And in areas where formal financial systems are highly centralized and corrupt, it may be unwise to link them to indigenous schemes. In Cameroon, for example, when a savings club -- the Banque Unie de Credit -- "went formal" in 1975, the government insisted on appointing a new bank director not chosen by its board members. This led to the bank's closing in 1979 (Miracle and others 1980). For these and other reasons, some argue that the best way to help ROSCAs might be to leave them alone (Shipton 1990). This sentiment might be too strong to apply universally but development officials should certainly exercise caution in working with informal systems. The strengths of both informal and formal systems should be thoroughly analyzed before any links are forged between them -- and, whatever links are forged, local control and equity interests should be retained.

If the possibilities for linking formal and informal finance are limited, what role should policy play? Development organizations could help disseminate information on successful informal financial models, such as the ROSCA, to areas that have not adopted them. In Ghana, for example, the Africa

2000 initiative -- supported by the Canadian International Development Agency -- is successfully disseminating the ROSCA message to villagers unfamiliar with this type of saving scheme (Julian 1990).

Financial institutions or government programs may also benefit from trying to emulate the attractive features of the informal systems. For example, in February 1987 Ghana's State Insurance Corporation initiated a susu-like program called Money Back to attract clients (Gabianu). Money Back provides life insurance and investment opportunities mainly to small and medium-scale businesses. As with the susu, clients determine how much to deposit (based on a scheme worked out with the corporation) and collectors visit markets daily to collect contributions. Money Back has several advantages. It operates on a familiar model, gives clients a secure place for their savings, and allows the corporation to mobilize money that would otherwise have been kept largely out of the formal banking system. Although the Money Back program is still in its early stages, its increasing popularity suggests that it may grow into a regionwide or nationwide program.

QUASIFORMAL ALTERNATIVES

To overcome the limits of formal and informal finance, governments, donors, and nongovernment organizations (NGOs) have developed innovative financial institutions to meet the savings and credit needs of poor people. Many of these programs started in the 1970s and early 1980s as demonstration initiatives operated by nonprofit institutions that were interested in experimenting with ways to improve poor people's productivity (Otero 1989).

Many of these projects have failed or fallen short of expectations, but some have reached the poor and sometimes the very poor -- without compromising their own financial discipline or institutional viability. Successful programs have not adopted a standard operating model, but share certain characteristics. Most have not emphasized subsidized interest: high borrowing rates and strict terms improve the chances that credit will actually reach the poor. Instead, they have adapted to local needs and overcome many of the hurdles (such as high transaction costs) that have impeded poor people's access to financial services. These systems have adopted the positive attributes of the informal system (such as increased flexibility) while maintaining the advantages of more formal systems (such as interest-bearing savings).

Measuring impact.¹⁰ Evaluations of microenterprise lending projects indicate that such programs can improve poor people's incomes and productivity considerably. In the Small-Scale Enterprise credit program in Calcutta, for example, incomes have increased an average 82 percent (Kahnert 1989). Similarly, studies of the Small Business Scheme of the National Council of Churches in Kenya (NCCCK) reported 10 percent to 14 percent increases in the net incomes of program participants, most of them women (Otero 1986).

¹⁰ Because of data limitations, the evidence provided emphasizes microenterprise lending.

Survey results indicate that KUPEDES lending has increased both employment in borrower enterprises and the incomes of borrower families below the poverty line. In 1986, the government's statistical bureau -- which uses guidelines consistent with the World Bank's -- showed that 15 percent of first-time KUPEDES borrowers fell below the poverty line. (This corresponds roughly to the incidence of rural poverty, which was 18 percent of the rural population in 1987.) After an average three years of program participation, this percentage dropped to only 4 percent for KUPEDES clients -- and average borrower income increased from \$74 to \$183 (Bank Rakyat Indonesia 1990, study summarized in World Bank 1990b: Annex III). Nationally, this means an estimated 186,000 families moved out of extreme poverty.

Hossain's (1988: 55-69) study of Grameen Bank's economic impact -- based on a comparison of project villages (those with access to Grameen Bank services) and control villages (those without) -- suggests even broader success. Hossain found both higher income participants and a lower incidence (62 percent) of moderate poverty in project villages than in control villages (76 percent).

A time series study based on a comparison of male and female microenterprises (microvendors and microproducers) with and without access to PRODEM project credit in Ecuador shows real monthly increases in net income between 1984 and 1985 for all groups except nonborrowing microvendors (see table 3 -- and Buvinic and others 1989: 222-246).

**Table 3: Average Net Monthly Income
for PRODEM Borrower and Nonborrower Businesses
by Gender, Type of Program, and Year (in sucres)**

	<u>Borrowers</u>		<u>Nonborrowers</u>	
	1984	1985	1984	1985
<u>Microproducers</u>				
Female	8,783	11,303	5,972	8,108
Male	15,807	22,043	11,969	18,112
<u>Microvendors</u>				
Female	6,500	9,029	10,281	9,983
Male	8,737	9,910		

The sample showed differences in income between borrowers and nonborrowers. Other factors affecting the study's design are discussed in Buvinic and others (1989).

SOURCE: Buvinic and others 1989.

The study found no significant differences in income between those with and without access to project credit, but there was a marked difference in

efficiency -- measured as hours worked (see table 4). PRODEM women microentrepreneurs decreased the number of hours they worked monthly by 14 to 17 percent, compared with only 4 to 7 percent for women nonborrowers. The authors conclude that women prefer efficiency because of their dual responsibility -- in the workplace and at home.

All of the studies demonstrate that providing poor people, especially women, with financial services can raise incomes and productivity significantly. The Grameen study suggests that the impact of these increases may stretch beyond the village. These highly positive findings make it important to understand which institutions contribute to this success and what methods they use to meet their poor clients' needs.

**Table 4: Average Hours Worked Monthly
and Average Hourly Net Income
for PRODEM Borrower and Nonborrower Business
(By Gender, Type of Program, and Year)**

	Borrowers					Nonborrowers				
	1984		1985		Percent change	1984		1985		Percent change
	H	I/H	H	I/H		H	H/I	H	I/H	
<u>Microproducers</u>										
Female	251	38	208	83	-17	181	39	169	60	-.07
Male	262	64	263	84	.004	238	51	239	81	.004
<u>Microvendors</u>										
Female	197	35	169	62	-14	205	50	197	50	-.04
Male	253	45	205	52	-19					

NOTE: H = hours; I/H = income per hour
SOURCE: Buvinic and others 1989

Types of institutions. A variety of innovative institutions have developed in the last 10 to 15 years to provide financial services to poor people. These institutions vary substantially in size, ownership, and organization (see table 5) but fall into certain broad categories with differing abilities to lend to poor people. The categories identified by McKee (1989) and Berger (1989), and discussed below, include innovative commercial banks, intermediaries, parallel programs, and poverty-oriented development banks.

* Innovative commercial banks. Recent experiments with innovative commercial banking programs that target low-income clients -- mostly small entrepreneurs -- have been demonstrably profitable. These programs usually are specialized operations within larger commercial financial institutions.

Examples include the small-artisan lending program operated by Banco del Pacifico (a private bank) in Guayaquil, Ecuador; the KUPEDDES and SIMPEDES programs of the government-owned Bank Rakyat in Indonesia (BRI); the Rural Development Fund of the government-owned Banco Industrial del Peru; and the private South Shore Bank in Chicago. Most of these programs still receive financial support from governments (Banco del Pacifico) or are government-owned, but they have successfully merged commercial and social banking objectives. KUPEDDES' net income exceeded \$20 million in 1989 (World Bank 1990b) and the South Shore Bank's profits reached \$1.5 million -- representing about 1.5 percent on assets (Taub 1988:1).

Institutions that still operate traditionally -- requiring land collateral for example, as KUPEDDES does -- have been less successful at reaching poorer groups. The nationwide KUPEDDES program has granted only 25 percent of its loans to women compared with 60 percent at BKK (which served as a model for KUPEDDES). But the formal banking system is probably the best model for offering credit and savings options to huge numbers of people, because of its institutional structure and branch system. More effort should be made to teach poor people, especially women, how to interact with commercial banks. And banks should keep experimenting with service delivery systems that will help them to meet the needs of poor people.

* Intermediaries. Intermediaries can help bridge the gap between poor people and commercial banks by forging links between the two. They commonly "retail" the credit from banks to small borrowers: they provide referrals and help with loan applications, training, and guarantees to lenders that reduce transaction costs to both borrower and lender (Berger 1989). Intermediaries are commonly nongovernment organizations (NGOs) or government agencies, financed by government subsidies or service fees charged to borrowers. With their experience working with government banks and NGOs, bilateral and multilateral donors may be well suited to encourage these links. Private banks looking to increase their clientele and governments looking to fulfill equity objectives may also be interested.

Women's World Banking (WWB) is one important example of this model. In early 1990, it had 46 affiliates operating in 35 countries. WWB provides training and financial and operational support. In Thailand, for example, WWB committed \$200,000 over a three-year period to a local affiliate (SEEDS 1990:5-7). Of this amount, 33 percent was a guarantee on the principal to Bangkok Bank, the collaborating commercial bank. The rest went to three local NGOs, who formed an affiliate, Friends of WWB, to provide operational and financial assistance. In addition to contributing \$30,000 as a guarantee to Bangkok Bank, the affiliate helped train poor borrowers in basic finance so they could make use of commercial banking facilities.

Table 5: Some Quasiformal Programs

Program	Country	Type	Year of Ref.	Years of Oper.	Total Beneficiaries	% who are women	Ave. loan size (\$)	% of loan funds in Arrears	Repayment rate (%)
ADEMI	Dominican Republic	NGO	1989	8	19,436 (88)	37	527	6.6	-
BKK	Indonesia	Quasi-govt.	1982	10	2,700,000	60	70	19.0	-
BRAC	Bangladesh	NGO	1987	18	169,000	55	31	-	92.5
BANCO DEL PACIFICO	Ecuador	Prov.	1986	-	4,210	26	300	-	-
CAMCCUL	Cameroon	NGO	1988	20	68,000 ^{a/}	25	2,264	24.0	-
GRAMEEN BANK	Bangladesh	Quasi-govt.	1990	9	800,000	87	58	-	98.0
IDESI (Informal Sector)	Peru	-	1987	-	140,570	57.1	1,375	-	-
KUPEDES	Indonesia	Govt.bank	1989	5	1,300,000 ^{b/}	25	425	5.4	95
PCRW	Nepal	Govt.	1989	8	6,640	100	59	-	90
FED	Ecuador	NGO	1989	4	2,937 (86)	71	1,150	.05	-
PRODEM	Bolivia	NGO	1990	3	13,200	70	200	-	100
SAVING DEV. MOVEMENT	Zimbabwe	NGO	1984	10	250,000 ^{a/}	97	-	.03	-
SEWA	India	NGO	1982	14	40,000	100	72 (76-80)	-	90 (87)
SFDP	Nepal	Govt.	1989	15	78,520	14	74	-	48
WWF	India	NGO	1989	12	50,000	100	-	-	90-95

Notes: a. Approximate
b. Number of beneficiaries in 1989
() Indicates year of reference for adjacent figure
NGO = Nongovernment organization

SOURCES: World Bank (1990 and 1990c); Hossain and Afsar (1989); Bratton (1986 and 1990); ACCION International; Berger and Buvinic (1989); Otero and Downing (1989); Sebstad (1982); Otero (1989); Boomgard and Angell (1990).

ACCION International is another example of an intermediary organization. Its network includes 50 affiliate organizations in Latin America and the Caribbean. ACCION coordinates their activities, uses similar methodologies in credit lending, maintains constant interchange among affiliates, and has reached more than 50,000 borrowers in 12 countries altogether.¹¹ ACCION provides these organizations such technical assistance and collateral, through a guarantee fund that allows local affiliates to borrow from local commercial banks. It also coordinates such affiliatewide activities as conferences, information dissemination, and resource mobilization. The organization affiliated with ACCION disburses \$2.5 million to \$3 million in small loans each month. In 1989, they lent more than \$25 million and had a default rate between 1 percent and 2 percent.

Several Latin American governments have set up similar organizations. The Institute for Development of the Informal Sector (IDESI) in Peru, for example, helped more than 40,000 microentrepreneurs -- mostly women -- get loans from a state-owned bank (Pinilla 1987, cited in Berger 1989). Similarly, the Nepalese government established Production Credit for Rural Women (PCRW), which trains both bankers and poor women. In 1989 it reached more than 6,500 women (World Bank 1990).

Intermediaries may face problems. First, they may encounter resistance from commercial banks as SEWA did in its initial efforts to link its clients and nationalized banks (Sebstad 1982: 80-82). Second, they may give poor clientele and banks little opportunity to learn about each other if they fail to train the commercial bank staff (Berger 1989: 1020). This leaves poor clients heavily dependent on the intermediary and fails to integrate them into the economic mainstream. Finally, unless nongovernment intermediaries can charge user fees that cover their costs, their scale of operation will be limited and they will remain dependent on government or donor resources.

* Parallel programs. In parallel programs, institutions -- usually NGOs -- are set up to provide financial services to the poor outside of the formal financial sector. Examples include ACCION affiliates (such as ADEMI in the Dominican Republic and FED in Ecuador), the Working Women's Forum in Madras, India, PRODEM in Ecuador, the Saving Development Foundation in Zimbabwe, and the Cameroon Cooperative Credit Union League (CAMCCUL). These programs have the advantages of grassroots organizations: they are well positioned and trained to work with disadvantaged groups, especially poor women. But they may lack the financial and management skills needed to run an efficient banking operation. Moreover, not having access to formal bank funds, they must fund both their operating costs and loan fund from deposits, donations, interest, and fees. Parallel programs that move toward the intermediary model and get access to commercial bank funds for lending can overcome this funding constraint.

¹¹ ACCION's affiliates are in Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Paraguay, and Peru.

* Poverty-oriented development banks. Some parallel programs have evolved into large-scale poverty-focused banks with access to central or commercial bank funds. These institutions are officially registered as banks, but focus on development and poor people -- which distinguishes them from commercial banks. Besides offering a limited range of financial services, they intermeditate socially in ways traditional banks would not. The Grameen Bank, for example, organizes its members into groups and presses for social development, in addition to providing financial services.¹² Using this model, the Grameen Bank has reached more than 800,000 people, mostly women. The large-scale Badan Kredit Kecamatan (BKK), which had coverage of about 2.7 million in 1982, is also in this category. It does not organize groups, but does work with local mayors, or luras, to get references and to identify poorer members of the community.

* Summary. Lending to poor people, especially poor women, is more difficult for some institutions than others. Financial expertise is only part of a successful operation. Also needed is some form of social intermediation or understanding that allows the financial institution to meet the needs of a diverse low-income clientele. Institutions like Grameen Bank successfully combine grassroots development and financial services, but this may not be a viable option for many institutions. Commercial banks operating in competitive banking markets must rely on more standard operating procedures (such as collateral) and may thus be less able to adapt to local needs (Mann and others 1989: 38-39). To meet the varying needs of a diverse and dispersed low-income population, each country may need many different kinds of financial programs. In Indonesia, for example, five types of private and quasigovernmental financial institutions at various levels serve small savers and borrowers (see table 6 and the Annex).

Key Components of Successful Delivery Models.

What are the chief characteristics of successful service delivery models? Successful programs improve poor people's access to financial services while maintaining financial discipline. Most programs, for example, do not heavily subsidize their interest rates and do link repayment to future lending. Successful programs also share common features that are modified to meet local needs. These include reducing transaction costs (for both borrowers and lenders), charging commercial interest rates, establishing deposit facilities, targeting poor clients (not poor sectors), developing institutional and borrower skills and emphasizing credit over business training in microenterprise lending. These features are discussed below.

* Reducing transaction costs. A prerequisite for increasing poor people's (women's) access to financial services is to reduce transaction costs for lenders and borrowers. This means decreasing the lender's risks and administrative costs. For poorer clients, it means finding nontraditional

¹² In 1984, Grameen launched a social development program called "Sixteen Decisions" which, among other things, teaches members how to increase productivity and invest in housing and education and to reject the concept of dowry.

Table 6: Indonesian Financial Institutions Serving Small-Scale Borrowers and Savers

Institution or program	Ownership	Geographical focus	Annual interest rates (on declining balance)	Size of loans (Rp)	Average size loans	Maturity range	Collateral required	Savings schemes
Private Banks/SCBs ^b /	Private/GOI	Main urban areas, provincial cities, and districts	20-30%	5 million +	n.a.	up to 5 years	formal title to real assets	yes
BRI/Unit Desas/Kotas (KUPEDES)	BRI/GOI	Kecamatan (subdistrict)	23-31% average	up to 25 million	780,000	3 months to 3 years	semiformal title to land or other tangibles	yes
Bank pasars	Private enterprises, government, or cooperatives	Kecamatan (subdistrict)	40-50%	up to 1 million	750,000	up to 1 year	inventory	limited
Provincial credit badans (BKK)	Provincial government	Village	29-130%	20,000 -- 200,000	60,000	up to 1 year	good repayment record	limited
Cooperatives	Cooperative members	Village	35%	varies by cooperative	-	up to 2 years	minimal	limited

Note: US\$ 1.0 = Rps 1,830 (as of May 1990)
 SCB = state-owned commercial bank
 BRI = Bank Rakyat Indonesia
 BKK = Badan Kredit Kecamatan
 GOI = Government of Indonesia

Desas = villages
 Kotas = cities
 Pasar = market
 Badan = agency
 N.a. = Not available

SOURCE: World Bank 1990b:4

methods of overcoming collateral requirements and decreasing the costs of intermediation with financial institutions. Strategies for achieving these objectives sometimes, but not always, involve group lending.

Successful programs have reduced loan risks by starting with small disbursements and increasing them in subsequent loans as borrowers establish a strong repayment record. Like many programs, the Badan Kredit Kacamatan (BKK) program in Indonesia complements this approach with other measures to reduce lender and borrower transaction costs. To decrease processing expenses and replace collateral requirements, tiny loans (first loans cannot exceed five dollars) are made on the basis of character references from local officials, one-page loan application forms are processed in less than a week, and loans are not supervised. To make things easier for borrowers, a mobile BKK team visits village community centers weekly to collect savings and distribute loans. Using this decentralized method, BKK services more than 35 percent of Java's 8,500 villages with almost 500 subdistrict BKK units and 3,000 village outposts (Goldmark and Rosengard 1983; World Bank 1989f; Ashe and Cosslett 1989; and Boomgard 1989).

Some programs have also taken steps to establish joint-liability, borrower-solidarity groups to reduce risks and transaction costs. Group lending supports several objectives simultaneously. First, it reduces the administrative costs of reaching dispersed individuals and processing loans. The Zimbabwe Agricultural Finance Corporation (AFC) incurs minuscule costs (1 percent of loan capital) by lending only to established groups (Bratton 1986: 129). The cost per unit lent in ACCION solidarity programs that have operated for more than one year is under \$0.10 per \$1.00 lent.¹³ If lenders must invest in forming borrower groups, costs for group lending (12 percent) may exceed costs for individual loans (11 percent) (Huppi and Feder 1989: 26). But once the groups are functional, group lending can reduce overhead costs. At Grameen Bank expenses as a share of outstanding loans are 16 to 25 percent for new branches (under one year), but drop to 6 percent after three years (Hossain 1988: 73-74 -- see table 7).

Second, group lending can decrease borrowers' costs. A comparative study in the Dominican Republic found that effective annual borrowing costs were 15 percent for a group and 18 percent for individual borrowers (Adam and others 1981). Generally, group borrowers saved on fees for collateral registration, expenses on certificates needed for loan applications, and transportation costs for visiting lenders (Huppi and Feder 1989: 26-27).

Third, group lending can reduce risks and collateral requirements when some form of joint liability is imposed on the group. Typically, one member's failure to repay jeopardizes the group's access to future credit. The best-known example of this approach is the Grameen Bank in Bangladesh which has successfully served poor people -- 84 percent of them women -- with loan recovery rates exceeding 98 percent (Hossain 1988: 50-54). The Working Women's Forum in Madras, India, has also had recovery rates between 90 and 95

¹³ Based on ACCION's October 1989 figures.

Table 7: Unit Operating Costs of Grameen Bank Branches,
by Age of Branch, 1984/85

Age of branch	Salary and allowances	Other expenses	Total expense	Amount of outstanding loans ^a	Expenses as % of outstanding loans
	(Tk thousands)				%
Up to 6 months	30.8	9.6	40.4	165	24.5
6 months to 1 year	46.0	13.0	59.0	365	16.2
1.0-1.5 years	72.8	15.8	88.6	1,041	8.5
1.5-2.0 years	87.8	17.8	105.6	1,576	6.7
2.0-2.5 years	94.0	19.6	113.6	2,015	5.6
2.5-3.0 years	100.8	18.8	119.6	2,198	5.4
More than 3 years	107.6	20.8	128.4	2,259	5.7

^a. Averages for the beginning and end of the year, except for the first two age categories, where figures refer to the end of the period.

SOURCE: Compiled from unpublished information sent by the branches to Grameen Bank's head office.

percent (Arunachalam: 4-5). Loan recovery rates for both institutions far exceed commercial bank national averages (World Bank 1989b:51).

ACCION's experience lending to solidarity groups has also been high repayment levels. The repayment rate in the 27 affiliated organizations averages about 96-97 percent, with a default rate of 2 percent. The most successful program in the ACCION network is PRODEM in Bolivia, which has lent more than \$9 million in three and a half years. Its repayment rate has never been below 99.5 percent.

Joint liability schemes may be especially important for women because they typically have little access to traditional forms of collateral. In ACCION, women's participation averaged 57 percent for group lending programs compared with only 30 percent for individual loans.¹⁴ Group lending may appeal to women because it builds on their traditional informal associations and networks (Otero 1989e: 3). Otero argues that the characteristics of informal women's associations -- especially rotating loan funds -- are similar to those of ACCION's solidarity groups. Like ROSCAs, ACCION's groups are found by self-selecting members with a specific objective who find ways to protect themselves from dissenting members.

¹⁴ Calculations based on figures provided by 27 ACCION International programs in 12 countries.

Fourth, groups offer human resource development for highly disadvantaged members. March and Taqqu (1982) in their study of women's informal associations found that women form groups for economic and political purposes as well as for support (such as child rearing). Groups help women find work, spread information, offer training, and provide access to resources in societies where women are excluded from more formal networks.

The success of group lending depends on member's confidence in each other, on management, and on local sanction. So small, self-selecting homogeneous groups -- such as those established by the Grameen Bank and in the Small Farmer Development and Production Credit for Rural Women programs in Nepal -- are usually the most viable. Government cooperatives established from the "top down" violate the principle of local sanction and have rarely been successful (Huppi and Feder 1989: 17-21). Government-controlled cooperatives such as the Indian Primary Agricultural Cooperative Society are susceptible to political interference that undercuts both their viability as financial institutions and their ability to reach the poor.

* Charging commercial interest rates. The 23-percent average real interest rate charged by a sample of USAID's microenterprise credit programs gives some indication of interest-rate levels that cover costs. BKK charges an interest rate of 3.6 percent a month. These interest rates cover operating expenses, including the cost of funds, and diminish the loan's attractiveness to elites. Charging commercial rates has allowed the Association for Development of Microenterprise (ADEMI) to be 100-percent locally financed.¹⁵ And like BKK, Grameen, and KUPEDES, ADEMI has achieved impressive repayment rates. In early 1990 only 6 percent of ADEMI's loans were in arrears. These financial institutions that charge market interest rates and maintain high repayment rates show that financial self-sufficiency and lending to low-income clients are not mutually exclusive.

Charging interest rates that cover costs has also contributed to the strong financial position of Indonesia's Unit Desa system (to which the KUPEDES and SIMPEDES programs belong). Boomgard and Angell (1990) assessed the program's profitability and liquidity and the quality of its assets and found that the system reached the breakeven point 18 months after inception and has generated steadily increasing profits ever since. In 1989, the system became self-financing, with deposits surpassing loan requirements. Also, the return on average assets over the last 4 years has increased from 2.7 percent in 1988 to 4.9 percent in 1988. The Unit Desa system's before-tax profits exceeded \$20 million.

But most programs that lend to poor people are still subsidized. The operating budgets of ADEMI and the Cameroon Cooperative Credit Union League (CAMCCUL) could be funded from earnings, but both rely on concessional sources of loan funds and receive free technical assistance. BKK's critical supervisory and control functions are not charged to the program (Boomgard

¹⁵ References to ADEMI drawn from Otero and Blayney 1985; Olivares 1985; Reichman 1989; and Boomgard 1989.

1989: 60). With that kind of subsidy, BKK earned \$1.4 million in profits in 1987 -- a 14-percent return on the year's consolidated average outstanding portfolio (World Bank 1989f).

Programs with a strong credit orientation -- such as innovative commercial and poverty-oriented banks -- highly value moving toward full cost recovery through earnings. Programs with broader objectives and stronger training and technical assistance components -- including the Bangladesh Rural Advancement Committee (BRAC) and the Self-Employed Women's Association (SEWA) in India -- put less emphasis on their own financial sustainability and more on the sustainability of their client's enterprises (Boomgard 1989:60). Not that they are financially lax. In 1987, BRAC's loan recovery rates were 90 percent for men and 97 percent for women; SEWA's were more than 90 percent in 1989 (Hossain and Afsar 1989).

It must be kept in mind, however, that to judge all credit and savings programs on the basis of whether their operations are financially self-sustaining is to ignore the important social and development benefits that are not reflected in profit statements (Boomgard 1989: 60). In some situations, governments or donors may be justified in continuing to support voluntary organizations or research institutions. All such decisions to subsidize should be based on a careful comparison of social benefits and costs.

* Establishing deposit facilities. Savings are another key component of successful programs (Vogel 1986; Huppi and Feder 1989; Ashe and Cosslett 1989; Von Pischke 1989; and Otero 1989). Even those who argue that the rural poor do not need more sources of credit for development (Howse 1983), have difficulty arguing against the need for better deposit facilities. Savings are essential to economic growth, help poor people accumulate assets, provide capital for financial institutions, and can substitute as collateral for poor borrowers (Ashe and Cosslett, 1989: 94).

Savings requirements vary substantially between credit programs, but certain characteristics are prerequisites for savings programs. Deposits must be secure and accessible and must yield a good return. What is less clear is whether savings should be mandatory or voluntary, but most programs that have mobilized savings require regular deposits to participate in the program (Otero 1989: 61).¹⁶ At BKK, for example, borrowers are required to save 3.3 percent of the face value of the loan every month, which helps capitalize the loan fund, insures against default, and gives borrowers a source of funds. Similarly, the Grameen Bank requires each member to contribute a sum equivalent to 25 percent of the amount of interest the bank charges into an Emergency Fund that acts as insurance coverage against default. Under a purely voluntary scheme, the SIMPEDES program in Indonesia (the savings side

¹⁶ Otero(1989) compares the different savings programs of several organizations -- the Grameen Bank, BKK, ACCION International, and the World Council of Credit Unions -- that have mobilized poor people's savings, and gives insights into the advantages and disadvantages of different approaches.

of the KUPEDDES program) has mobilized more than \$645,000 from 6.7 million rural savers (Rhyne 1990; Boomgard and Angell 1990).

When risks are high and access to funds is limited, it may be appropriate to start financial service programs with deposit facilities. SEWA, for example, started as a savings depository for poor women making small deposits. In 1974 SEWA's "mobile" unit began visiting women's homes and places of employment to collect savings and fulfill an unmet demand: local banks were unable to service such a dispersed and illiterate clientele. SEWA did not disburse any loans until 1976 (Sebstad 1982: 82-85).

The Saving Development Movement in Zimbabwe continues to rely on its members' savings. The membership -- 250,000 in 1985 -- uses its savings to place bulk orders for fertilizer and seeds. Rural women -- 97 percent of the program's participants -- become more financially independent through their own savings (Bratton 1990).

* Targeting poor clients. Successful programs are effective at targeting poor clients. Organizations like SEWA, BKK, and the Grameen Bank target with considerable success. A random sample survey of Grameen Bank borrowers revealed, for example, that more than 95 percent of its participants came from households that owned less than 0.5 acres of cultivable land. Why were these programs successful at targeting? Unlike traditional, formal credit programs, these quasiformal initiatives target poor clients directly.

But targeting poor clients effectively requires familiarity with their needs, which requires market research. It also necessitates being able to develop a service or product that meets local needs. By understanding a new product or service's potential users and their needs, innovative financial institutions can decrease the risk of innovation (Von Pischke 1989: 182-183).¹⁷

By contrast, formal, regulated programs have tried to target low-income clients with lending targets, quotas, and subsidized interest rates -- and have emphasized lending to priority sectors (usually agriculture and small farmers). But this kind of targeting has led more to rent seeking and political interference than to poverty reduction -- indeed, has proved to be an almost sure-fire way to miss the target.

But innovation and market research can be difficult, costly, and time-consuming, especially when clients are highly dispersed, illiterate, and marginalized by cultural barriers that keep them out of the formal economy. The Grameen Bank, for example, started as an experimental project in 1976. After three years of field experience and experiment and years of gradual project expansion, the Grameen Bank was formed in 1983. SEWA began as an intermediary between nationalized Indian banks and poor women in 1972. After considerable experiment and evolution, it finally became a bank in 1976.

¹⁷ Von Pischke argues that successful programs are characterized by their ability to create market niches among new low-income clients through innovative service delivery.

As more information is gathered on successful lending models, less research will be needed. We now know, for example, that small self-selecting groups are more effective than larger impersonal ones. But local variations call for experimentation. Donors and governments can support research efforts with funds and technical support and can help disseminate the results.

* Developing skills and institutions. Poor people who have never used a bank account or filled out application forms must be taught how to do so. Learning about institutional credit increases clients' confidence in themselves and in the financial institution. Training and confidence-building are particularly important for women, who are likely to have less formal education and familiarity with formal procedures. This investment increases initial transaction costs for both the financial intermediary and its clients, but is absolutely essential (Von Pischke 1989).

At ADEMI, for example, advisors escort new clients to the bank and take them step by step through check-cashing and depositing procedures (Reichmann 1989: 153). At the Savings Development Movement, households are organized into neighborhood groups and are taught a financial record-keeping system illiterate people can use (Bratton 1990). The Grameen Bank devotes painstaking attention to building its new clients' confidence and skills. Group members need confidence because they are often nervous about taking a loan and striking out on their own in activities funded by that loan (Von Pischke 1989). After they form, groups receive seven days of instruction from Grameen Bank workers.

Financial institutions also need training and assistance. Financial services programs require well-functioning institutions and qualified staff to maintain performance and ensure sustainability (Huppi and Feder 1989; Braverman and Guasch 1989; Mann and others 1989; Holt 1990; Salmen 1990). USAID's stocktaking study found that successful lending institutions shared the following characteristics:

- A clear, unambiguous objective that is well understood and accepted at all levels of the organization.
- Strong and charismatic leadership by an individual with strong links to local elites.
- A well-trained staff whose dedication is cultivated through training, equitable personnel plans, and financial incentives. BKK, for example, divides 10 percent of its profits among its staff.
- Decentralized organization, with responsibility and authority delegated.
- Tight management information systems and forms of financial control, often computerized.
- Flexibility -- especially the ability to learn from experience and adapt to changing circumstances (Boomgard 1989:72).

Financial assistance from governments and donors can also be important to client training and institution building.

* "Minimalist credit" or "credit plus." One issue still under debate is the relative merits of minimalist credit and "credit-plus" for microenterprises.¹⁸ Credit-plus programs provide business-training and other services, such as marketing, to small and microentrepreneurs. It is widely recognized that microentrepreneurs lack the skills and training that could help them expand their businesses, but the role and value of training in enterprise development is less well understood than the role of training in credit. Classroom accounting and marketing have little relevance to microentrepreneurs. And many financial institutions do not have the staff to provide adequate training in these areas. The USAID evaluation of microenterprise programs concludes that the history of training and technical assistance for business development of microfirms is largely a story of failures (Boomgard 1989: 70).

In a review of several Latin American credit programs for microenterprises, McKean found that the minimalist programs that provided little or no technical assistance had as strong an impact on borrower's income as credit-plus programs (Berger 1989: 1026). These reports do not prove that microentrepreneurs cannot benefit from business training, but they do strongly suggest that more research and experimentation are needed before successful programs can be initiated.

5. CONCLUSIONS

The dismal experience with regulated, subsidized credit offers clear policy lessons. First, regulated and subsidized credit does not reach the poor or mobilize savings, and weakens financial sectors and institutions. The World Bank and other donors have already begun working with governments to remove distortions in the financial sector -- for example, by liberalizing interest rates and lifting regulations that make it illegal for institutions to charge different interest rates to different customers. Second, credit by itself -- without strong markets and infrastructure -- cannot contribute to income generation. Credit schemes are no substitute for broader policies and investments to foster economic opportunities for the poor.

Reforming the financial sector will strengthen and expand it but may not automatically give poor people, especially poor women, more access to financial services. Sometimes the barriers to formal credit are deeper than interest rates or physical access to banking facilities.

¹⁸ The debate is limited to microenterprises. Few argue with the need for training in other areas, such as agricultural extension. And for larger businesses, there is better understanding of training needs. Traditional marketing and management information systems become increasingly relevant as firms grow.

Measures that increase poor people's access to financial services generally focus on developing either informal or quasiformal financial alternatives -- or both. Investments in informal finance -- the traditional source of credit and deposit facilities for poor people -- should emphasize replicating existing services and building links to formal finance, although experience in the latter is rare. Donors and governments could support research and experimentation in forging links between informal and formal systems, but care should be taken not to weaken a well-functioning informal market because the formal sector is not properly run.

One possibility is to replicate or to disseminate information about successful informal systems. Grassroots organizations (NGOs or government extension programs) could teach poor people who are unfamiliar with informal programs such as ROSCAs how these savings clubs operate. Such programs could be especially helpful to groups with little chance of getting access to more formal schemes. Ghana's Money Back program -- a government-established insurance program based on an indigenous informal scheme -- demonstrates how successful informal models can be copied in formal markets. Countries can make their financial programs more attractive to low-income clients by experimenting with such approaches. It can be difficult for organizations that do not have a local presence to conduct this kind of training or disseminate information locally. But this should not stop organizations like the World Bank from providing assistance to local organizations.

Quasiformal programs offer the greatest scope for policy action. The main policy question is whether subsidies are necessary. If so, what should be subsidized and for how long? What criteria should be used to evaluate performance?

Subsidies may be called for to develop quasiformal financial institutions for poor people because of the high startup costs for investments in training (both of staff and clients), group formation, and research and experimentation. But it is not clear how long these subsidies should last. For programs with a credit orientation, subsidies should be withdrawn as costs decline and financial self-sufficiency should be a central goal. But for programs that emphasize training or technical assistance, subsidies should be longer term. Clear guidelines on how to evaluate these subsidies have yet to be developed, however.

Interest rates should not be subsidized. Rather, subsidies should finance administration, training, and institution-building -- the management-intensive parts of project design, implementation, and supervision. These activities can be time-consuming for donors and government agencies, but may be allotted proportionately little of the program's subsidies. At KUPEDES, for example, a full-time staff from the BRI and the Harvard Institute of International Development have spent more than three years giving the program management and supervisory support.

Support is also needed for research. New financial institutions that serve poor people must investigate prospective clients to assess their needs and develop a service delivery model suitable for local circumstances. More general research is also needed. Topics that need exploring include whether

small and microentrepreneurs need business training (and what kind) and what priority to assign to credit for small and microentrepreneurs in demand-constrained economies.

In conclusion: well-designed and implemented financial services programs can help poor people increase their productivity and income. And these programs can be an effective way to reach poor women, who are typically left out of traditional credit schemes. Both donors and governments have a role to play in helping these institutions develop. But credit should not be viewed as a panacea for reducing poverty: it is not appropriate everywhere and for everyone. And it is only a small part of the much larger policy changes and investments needed to foster the growth that reduces poverty.

Annex

Many kinds of financial programs may operate to meet the needs of one country's diverse and widely dispersed low-income population. In Indonesia, for example, five types of private and quasigovernmental financial institutions work at various levels to serve small savers and borrowers (see table 6).¹⁹ At the lowest level are the Koperasi Unit Desas (KUDs), or cooperatives, some of which can be classified as parallel programs. The KUD credit programs are usually funded from official sources; few savings are mobilized and loans go only to cooperative members. The KUD's track record has been poor (like many government cooperatives), and most of the KUDs currently operating look more like traditional subsidized credit schemes than second-generation projects. But in the past four years, the Bank Umum Koperasi Pinjama (BUKOPIN), with help from the Dutch government and the Rabobank Foundation, have started a pilot program to transform these organizations -- and have had some success.

At the next level are the provincial banking networks, which are poverty-oriented development banks. The best-known is Badan Kredit Kecamatan (BKK) in Central Java; others include the Kredit Usaha Rakyat Kecil in East Java; and the Lumbung Pitih Negari in West Sumatra. Most of these institutions are locally administered and financially autonomous. Provincial authorities provide the initial capital, and the rest comes from mandatory savings and revenues. Their nontraditional style -- for example, they rely on social pressure and references, not collateral, and they use mobile banking units -- allows them to serve small traders, many of whom are women.

Bank Pasars, or market banks, are somewhere between poverty banks and innovative commercial banks. More than half are privately owned. Typically they are located in large provincial cities and conduct business in nearby markets. They specialize in short-term loans to petty traders, for which they charge about 3.5 percent a month. They require collateral in the form of inventories, fixed assets, or durable goods worth 150 percent of the value of the loan. They do not tend to reach poorer groups.

The Bank Rakyat Indonesia (BRI) Unit Desa network -- which includes the KUPEDES and SIMPEDES programs -- is an innovative commercial bank system. It is Indonesia's largest nationwide banking system, with some 2,850 subdistrict or village-based subbranches and 835 posts. This network bridges the gap between provincial banking institutions and large -- usually city-based -- private and public commercial branches. Its development over the last six years demonstrates the potential for mobilizing savings mobilization and for introducing small-scale savers to formal banking. KUPEDES is the main source of financing for small (but not the smallest) borrowers, 25 percent of whom are women. Its lending rates are not subsidized, permit full cost recovery, and yield BRI a profit. At the end of 1989, there are 1.6 million outstanding loans worth \$460 million.

¹⁹ The information on Indonesia's lending programs is summarized from Berger (1987) and World Bank (1990:4-6).

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