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SMALL AND MICRO ENTERPRISE CREDIT:
RECOMMENDATIONS AND CASE STUDIES PRESENTED AT THE "BEST PRACTICES" WORKSHOP

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"BEST PRACTICES" CASE STUDIES

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INTRODUCTION

The "Best Practices" Workshop for successful NGO credit providers was designed to be the midway point in an on-going information and experience sharing process.

The process began over one year ago with extensive research and subsequent field interviews with nine African NGOs selected on the basis of the quality of their programs:

- Get Ahead Foundation (RSA);
- Group Credit Company (RSA);
- Independent Business Enrichment Center (RSA);
- Small Enterprise Foundation (RSA);
- Kenya Rural Enterprise Program (Kenya);
- Kenya Industrial Estates/Informal Sector Program (Kenya);
- PRIDE (Kenya);
- Agence de Credit pour l'Entreprise Privee (Senegal); and,
- Federation des Unions des Cooperatives d'Epargne et de Credit (Togo).

These nine African NGOs sent a total of 19 representatives to participate in the three day workshop which was sponsored by A.I.D./AFR/ONI/PSD. A request from the participants that only African credit program managers be allowed to attend Workshop sessions during the first two days was honored by A.I.D. On the third day, donor representatives from U.S.A.I.D., World Bank, Ford Foundation and other organizations were invited to participate in a discussion of how best to achieve long-term, continent-wide impact.

The "Best Practices" workshop sought to develop both short and longer term responses to challenging questions which are the focus of sections one, two and three of this report.

- What key factors have to be considered when deciding how best to design and manage an efficient, cost-effective program for poor people denied access to traditional credit?
- How can managers of successful African NGOs establish quality control standards to up grade the financial management performance of less sophisticated credit programs throughout the continent?
- How best to prepare case studies of African NGO credit providing organizations so that program managers and designers can learn from experiences on their own continent?

The "Best Practices" Workshop developed a new approach to share what has been learned by the managers of Africa's most successful NGO credit-providing programs.

The African NGO credit program managers were reluctant present themselves as the ultimate experts convened to tell other practitioners what to do and how best to do it. They preferred to share their insights about what factors credit managers need to consider when making their own decisions about how best to design and implement a cost-effective and locally appropriate program.

SECTION ONE

I. FINANCIAL MANAGEMENT FACTORS TO BE CONSIDERED

The "Best Practices" Workshop participants agreed that their most important shared need was to improve "damage control" policies and procedures in order to cope more effectively with loan arrearage and defaults. They opened dialogue by discussing factors to be considered and offering some recommendations.

How To Control Damage From Arrears And Defaults?

Kenya Industrial Estates/Informal Sector Program:

Just as loans are different, borrowers are different. With some you have to be hard, others will listen to reason. The important thing is to know your borrower, the level of risk in their loan, and the value of their collateral before you decide how to recover a delinquent loan.

KIE/ISP formerly followed a policy of repossessing collateral on all defaulted loans, but soon found itself overwhelmed with repossessed goods. They also found that once they repossessed collateral, the client considered their loan to be paid off and stopped making payments.

To avoid a surplus of repossessed goods, KIE/ISP now measures the risk of the outstanding loan against the value of the security, tailoring their approach to the individual client and their level or risk. If a borrower has already paid back 80% of the value of their loan and has fallen a few payments behind, field agents will try to

pressure him/her to catch up on their payments rather than repossessing their collateral.

Group Credit Corporation/South Africa:

Incentives for repayment and sanctions for delinquency must reflect the socio-economic circumstances in which they are applied; environment must dictate loan policy. To get a clear idea of the environment that your borrowers are working in you must listen to them about what works and what doesn't work in their unique circumstances.

For example, problems with repayment in South Africa are greatly compounded by the instability of the current transitional political situation. Using second loans as an incentive for repayment has little effect because many borrowers think that all loans will be forgiven after the apartheid system falls. Because of the current political situation, and the mentality it creates, GCC emphasizes prevention of arrears as the key to repayment.

Embarrassment is the best tool for preventing delinquencies. Loan officers should first follow-up to encourage repayment, then nag, then finally embarrass the delinquent borrower until they repay.

It is much better to collect repayment than collateral. After you have seized a borrowers collateral, they often think that their loan is repaid, even if the value of the collateral does not cover the value of the loan. Selling off collateral rarely recovers

the value of the loan because seized goods are often in bad shape and no one is willing to pay full price for them.

Taking a non-paying borrower to court doesn't always mean you will win. Some clients are even happy to be sued because a judge will often allow them to pay back their loan at a lower interest rate over a longer time period. The benefit in going to court is that only by suing a non-paying borrower can you get a court order for them to repay. If they refuse to obey a court repayment order, then they can be taken to jail.

Kenya Rural Enterprise Program (K-REP):

Sometimes it is not enough to know that a borrower has defaulted. You have to look at the person to find out why they defaulted. Did they have bad luck in the market, or are they a professional defaulter? Did they use their loan for consumption, or did they not invest it according to their business plan?

To reduce arrears you must practice management by exception. Look first at what is wrong, not what is right, what is your risk exposure, not what is your repayment rate. At every meeting, field agents report on a group's level of arrears first. Field agents don't wait until repayment becomes a problem, the nagging to repay begins immediately.

In addition to negative incentives for delinquencies, you should also offer positive incentives for on-time payment. Borrowers with the best repayment records should be offered the first opportunity for follow-on loans. It should be made clear to

all borrowers that if they have a good repayment record, they will be able to get more loans in the future.

Using savings as collateral is a good incentive to repay, but it is not sufficient. To enhance the commitment to repay, solidarity group members have suggested that the property of individual defaulters, no matter how small, should be repossessed. Members should pledge their collateral to the group, not to the lender, so their promise to repay is both an individual and a group commitment. This system also provides the lender with an added layer of security: the collateral of group savings.

PRIDE/Kenya:

Repossession of group savings has a negative impact on a solidarity group and creates a disincentive to remain in the group. Local government authorities have sometimes helped encourage repayment by holding defaulters in jail until their family promises to pay back the loan.

PRIDE requires borrowers to form five person solidarity groups. Borrowers are then organized into Market Enterprise Committees composed of three to ten solidarity groups. The value of solidarity loans is collateralized by individual savings and by a group guarantee.

Each borrower is allowed four arrears, after which their loan is recovered from their savings. If their individual savings is not sufficient to cover the value of the loan, savings are taken from their solidarity group. If the savings of their solidarity group are insufficient, money is taken from the savings of the larger Market

Enterprise Committee. Any money that is later recovered from the borrower is credited back to their solidarity group or Market Enterprise Committee.

ACEP/Senegal:

The first idea you must plant in the minds of your borrowers is that all loans must be repaid. From the start you must create the mentality that repayment is mandatory, not optional.

Strong guarantees are the best way to prevent arrears and defaults. ACEP prefers guarantees that are easy to valuate, confiscate, and resell in the case of default. Jewelry is the surest guarantee and it is the easiest collateral to resell. It is important to be able to accurately value the worth of a collateral guarantee because ACEP will only give loans up to 70% of the value of the guarantee.

ACEP has accepted mortgage guarantees for loans, but they are somewhat unwieldy and not effective for smaller loans. Even though ACEP usually would not sell a house to cover the cost of a small loan, psychological pressure can be put on the borrower by threatening to sell their house. The fact that ACEP holds title to their house is usually enough of an incentive to repay.

Preventative follow-up is one key method for reducing arrears. Headquarters and field staff know by the 5th of the month if a payment is late, and field agents quickly visit the borrower to find out why they are in arrears. It is better to prevent arrears than to repossess collateral. Timely follow-up can help you avoid arrears and avoid having to use the legal system to recover your loan.

When and How to Provision or Write Off Loans?

One approach is to require 3% of the value of the loan up front as a non-refundable default insurance fee. This money is invested and held in reserve to cover bad loans.

Another approach is to require .5% of the value of the loan up front as an insurance fund and collect a fee of 1% of the value of the loan every month in case of default.

Yet another system is to charge a higher interest rate than you need to break even, and refund a percentage of the interest charges when the loan is repaid. If the loan is not entirely repaid, you at least have the extra interest income.

Some organizations hold separate accounts for loan defaults and loan insurance. In the case of a default, the borrower's collateral is repossessed and used to cover the value of the loan. The loan is then written off and the difference between the value of the collateral and the value of the loan is taken from the sinking fund. If on the other hand, the borrower cannot pay back their loan for a legitimate reason, the value of the loan is deducted from the insurance fund.

FUCEC in Togo provisions a loan after one month of non-payment. The percentage of the loan provisioned depends on the level of risk involved.

K-REP in Kenya provisions once a year after the annual audit. When a loan is provisioned the primary guarantor is contacted first, then the secondary guarantor, then the collateral is repossessed.

GCC in South Africa uses the same methodology for provisioning loans as the Standard Bank of South Africa: after 60 days of non-payment, loan interest is separated from capital; after 90 days the full loan amount is provisioned; after 180 days the debt is reported as a write off. Semi-annual meetings are held to deal with the provisioning of bad debt.

How To Effectively Screen Potential Borrowers?

In Kenya small and micro lending organizations recently linked together to develop a system to share information on client credit histories. Through this system lenders will be able to check on whether a potential borrower has repaid past loans, and whether they have outstanding debts with other creditors.

This system is intended catch borrowers who borrower from one lender to pay back a loan from another lender. The system will also indicate if the borrower has a good credit history, which allows a lender to approve larger loans for better borrowers. Checking a potential borrower's credit history not only protects the lender, it also rewards good repayers.

IBEC in South Africa uses a credit agency to obtain credit histories on potential borrowers. South Africa has a sophisticated financial system, and many South Africans buy goods on installment. IBEC can therefore access a borrowers repayment history on installment purchases before offering them a loan.

Visiting a potential borrower's business and home can provide important clues to estimating whether or not they will be a good borrower. If, in visiting their home,

a field agent sees that they have a large family and are obviously not able to feed them, the agent can anticipate a poor repayment rate. If, in visiting their business, your field agent sees no customers in the shop and dusty merchandise on the shelves, the business is not doing well enough for the borrower to make regular loan payments. This type of information can only be gathered through site visits by field staff.

For PRIDE/Kenya, client screening and loan application appraisal take place in the field at the level of the solidarity groups. Each solidarity group has a loan appraisal committee which is facilitated by a PRIDE loan officer. If the loan is approved by the appraisal committee then it is sent to PRIDE's regional loan officer for final approval.

For ACEP/Senegal, client screening is done through site visits by branch supervisors and through rigorous loan selection criteria. The branch manager is required to visit the work place of every borrower to check that the information on the application form is accurate and to ensure that the borrower is capable of paying back their loan.

Although loan applications are prepared and by field agents, final loan approval remains the decision of the ACEP credit committee. Members of the credit committee think only of the bottom line of loan repayment and are encouraged to disapprove any questionable loan.

Through occasional unannounced spot checks on clients, K-REP ensures that borrowers are using their loan for the purpose they described on their loan

application. To ensure that a client has not set up a business solely to get a loan and that they are using their loan for the business it was intended, a K-REP agent will drop in on the shop without warning them in advance. Sometimes they will make arrangements for a visit, then return to the shop a few hours or a few days later to see if the shop is still doing business or if they were just putting on a show for the loan officer.

How to Set Interest Rates and Service Fees?

What are market interest rates? Should organizations compare their interest rates to formal sector market interest rates or informal sector usurious interest rates?

No one in the commercial credit market is offering the same services to the same clientele, therefore no other market rate applies to SME lending. Although commercial interest rates sometimes appear lower, the real cost of borrowing from a bank, even for clients who have access to banks, is often higher after bank fees and charges are added in.

The affordability of the interest rate is a non-issue. Borrowers are more concerned about access to credit than about the difference between your interest rate and the interest rate offered by a bank.

The higher your interest rate, the more clients you are able to reach. The lower your interest rate, the less you are able to grow as an organization and the fewer people will be able to reach.

Base cost of services on ability/willingness to pay. Set your interest rate 12-15% above the commercial interest rate to cover increased risk of making small loans in the informal sector and to ensure financial sustainability.

It is important to make accurate cost projections the first time around. Decide on your interest rate by calculating your program costs, then setting your interest rate to break even. An organization's interest rate should reflect the true cost of borrowing.

GCC charges a flat interest rate across the board. They arrive at their interest rate by deciding what effective interest rate they need to charge, and then adding on a substantial premium at the front end to encourage good repayment.

For example, if they wanted to charge a 25% effective interest rate they would offer loans at 50% and refund 25% of the interest accrued after 6 months as a repayment incentive. They have found that this system is more effective than struggling to collect fees from delinquent borrowers.

If a borrower does not make payments on time, they have already paid their 25% delinquency fee. If they do pay on time, then they have that 25% refunded to them. Even at a 50%, GCC's interest rates are lower than those of traditional moneylenders.

NOTE: In general, although no attempt was made to reach consensus, the "Best Practices" Workshop credit practitioners tended to agree on their responses to these key questions. However, there was some disagreement on whether interest rates should be charged on a sliding scale, charging more to those better able to pay in

order to subsidize cheaper loans to poorer people. The following are some representative comments from that discussion:

Do not offer a subsidized interest rate to poorer borrowers. Those who want to borrow can afford it, and charging a real, positive interest rate both avoids dependency on donors and ensures organizational sustainability.

If you differentiate interest rates, (charging less to the poor) then your staff will be biased towards lending to rich borrowers. It is easier to lend to richer clients, and the revenue from interest charges on larger loans and fees for services is higher.

Subsidizing loans to poorer clients sends a mixed message to your clients and staff and negatively affects the commercial culture of an organization. It is difficult to change the perception of a soft, hand-out organization to that of a business-like organization.

Lower interest rates should be offered the very poor. When clients graduate to larger loans they should be charged a higher rate to cover the cost of subsidizing loans to the poor.

How To Cut Costs To Increase Sustainability?

Even in a strict cost control regime, you must be flexible enough to respond to changing needs. Decrease costs by decreasing useless procedures and useless paperwork. Don't require lengthy reports, let the numbers do the talking.

Cost control is linked not only to your loan portfolio size but also to its quality. If you try to decrease costs by pushing staff to increase the number of loans per officer, you may actually decrease the quality of your loan portfolio.

Incentives should be offered to staff based on the performance of their loans, not the number of loans. Good incentive schemes can reduce costs by improving the quality of the portfolio.

Motor pool costs can be reduced by offering a car allowance to field agents and having them maintain their own vehicles. Some organizations offer loans to their field managers so they can buy their own car. Field managers are happy to have a car loan, the cars are well-maintained, and the organization pays only for work-related use of the vehicle.

Office expenses can be reduced by requiring staff to pay for personal use of office equipment (telephones, copiers, etc.) Keep monthly track of branch office expenses to catch excessive expenses early on. This close monitoring is more costly in the short run, but it saves money in the long run.

Ceilings should be put on all office expenses. These ceilings should be flexible between accounts, but if a branch office exceeds their ceiling for one account they must apply to headquarters to shift funds from another account.

Overhead costs can be reduced by stationing loan officers in their home region and not allowing per diem for overnight travel. Also, offering your employees a reasonable salary will cut down on pressure from staff for per diem.

How To Do Strategic Financial Planning?

The basic units of analysis for financial strategic planning are: average loan size, staff productivity (loans per loan officer), cost of money, cost per loan delivered, and sensitivity analysis.

The strategic planning model you use depends on the financial model you select and whether you perform a break-even analysis or a sensitivity analysis. Whichever system you use, it is imperative to have a good financial forecasting model.

An organization must always keep in mind what its spread is and what its break-even point is. It is also important to do sensitivity analysis of how your break-even point is affected by increases or decreases in variables such as the cost of money, operating expenses, number of loans outstanding and average loan size.

Sensitivity analysis should take into account such variables the changing cost of loans over time (the older the loan the higher the risk of arrears and default) and the different cost of various types of loans.

Strategic financial planning requires a recognition of the important effects of inflation. A positive differential must be maintained between the rate of inflation and your interest rate. If inflation is increasing by 25% every year, your interest rate must increase by the same amount in order for your organization to continue to break even.

The following is a brief list of potential income sources: interest income from loans, interest income from savings, savings mobilization, transaction fees, service

charges, brokerage fees, default insurance fees, training fees, consultancies, external investments (stocks, bonds, real estate), donor money, government money, and endowment funds.

Endowment funds are an attractive source of income. If you can convince donors to give your organization an up-front grant, then you can use the interest on the grant as a source of income.

Encouraging borrowers to save is another way of raising extra funds. However, before anyone will save money with your organization, you must assure them that their money is safe and they can have access to it whenever they want.

Requiring savings can increase program revenues, but investing these savings is risky. Some organizations have a policy of never investing borrowers' savings.

How to Decrease Donor Financial Dependency?

Decreasing donor dependency should be a stated organizational objective. There is no excuse for not making it one. Even if you have sufficient funding, you must think of independence. Diversify your donor funding sources. Even if you have lots of money, you must work for independence.

Define an incremental disengagement strategy: independence from donors takes time and must be planned for from the beginning. Set annual goals for decreasing dependence. The staff will be more responsible in their use of resources if they know they have to raise the money themselves.

Organizations must be aware of the pitfalls of donor dependence, especially when donor priorities or politics change. Don't choose activities solely because donors' are funding them. Choose activities that the organization needs or wants to do, and then seek funding for them.

Organizations need to charge market rates to be sustainable and to reduce dependence on donors. Informal sector entrepreneurs can afford to pay for services. Plan for eventual sustainability as clients ability to pay increases. Financial sustainability should be approached in steps. It is a long-term and difficult goal to achieve, but every organization must plan for it.

Donors must realize that their money is funding organizational growth in the short term and that sustainability is a long term goal. If an organization's only goal is sustainability, it can become sustainable in a short time in a small area, but its growth will be limited and localized and it will not have a nation-wide impact.

Most SME organizations are in an expansion phase and will not be able to achieve true sustainability until they have stopped expanding, established themselves as an institution, and become profitable.

To increase the scope of your impact, your organization should introduce new loan products. To increase scale of your organization should increase sales of existing products. It is important to grow within your market niche, but it is equally important to diversify, both within your market niche and to new markets.

Be realistic in assessing your market niche. One reason that commercial banks do not offer SME loans is that the transactions cost of moving such small loans is

very high. To enhance your financial viability, you should combine small loans with larger loans. Don't ignore smaller loans in search for profitability, but remember that a few large loans can help defray the cost of many small loans.

Although increasing your scope can be an important way of enhancing organizational sustainability, it can bring on the risk of over-diversification. Over-diversification results from a loss of organizational vision and often happens when an organization ceases to focus on its comparative advantage.

What Should Be Done about Savings Mobilization?

There are many fallacies about the savings behavior of the poor. The poor can and do save. Even in very poor areas, people keep savings under their mattresses.

Most SME credit organizations are not set up to take savings and many are not allowed to by law. One way to circumvent legal restrictions on holding savings is to encourage and assist borrowers to form their own savings clubs.

Savings can be used as collateral and can provide a strong encouragement for clients to repay. After serving as an up-front guarantee, savings can be returned to the borrower at the end of the loan. By requiring saving as a precondition to borrowing, clients may save at first only to be able to take a loan, but later they see the utility of saving and it becomes a habit.

Savings mobilization is a basic goal for credit unions, cooperatives, and other membership organizations. Combining credit with savings creates a mentality among

members that they are borrowing from their own savings. Loans issued from member savings are looked at differently than loans from the government or from an international donor. Members know that the money they are borrowing belongs to them and to their fellow members, not to an outsider.

NOTE: Participants in the "Best Practices" Workshop did not agree on the advisability of confiscating savings when borrowers default on repayment.

Confiscating savings as collateral for group loans punishes the good for the sins of the bad. If one person defaults then the whole group suffers the loss of their savings

Confiscating savings is not a punishment because solidarity groups are formed through self-selection and borrowers were free to choose their fellow members. If one of their members doesn't pay, you can be sure that person will be excluded from the group the next time they apply for a loan.

What Is Your Policy on Solidarity Group Loans?

It is too early to say whether solidarity group lending is an effective strategy for Africa. More time will be needed to see whether incentives to remain in solidarity groups are strong enough.

The problem with the solidarity group methodology is that loan sizes are limited and they may not be appropriate to the size of the businesses concerned.

Solidarity group lending is most effective for shorter term loans. After about six months group members tend to build up resentment if one member does not pay

on time (even if it is not the member's fault). Many solidarity groups tend to dissolve in the long run.

Membership in a solidarity group is not a sufficient criteria for granting loans. Loans should be approved only for solidarity groups with good collateral.

II. PERSONNEL MANAGEMENT FACTORS TO BE CONSIDERED

How Do You Decide Who to Hire for Staff Jobs?

The level of candidates you recruit can be a serious staff selection problem. If you recruit at too high a level, then your employees may become dissatisfied and end up being bad loan officers. If you recruit at too low a level, you may create and invisible wall which prevents you from promoting employees into higher management positions. The key is to recruit the right level of person for the right level of job.

Avoid hiring candidates with too much experience or with experience in a bureaucratic culture. If they are too habituated to office work, they may be susceptible to corruption, and may not be willing to spend time in the field. Don't hire ex-bankers or ex-government employees.

Look for candidates who have at least two years experience in dealing with the public. Candidates should have experience in sales or marketing, or have held any other job that required them to explain things to the public.

Look for staff who understand risk. Those who understand risk have good potential for promotion to management.

In interviewing job candidates situational questions that show how an applicant thinks are more important than technical questions that test their level of training. Ask questions that reveal how a candidate handles people. The ability to work well in a team is more important than the ability to do advanced financial calculations.

The following factors should be considered when deciding which job applicants will made the best staff members: experience, age, gender, education, resident of region, knowledge of the local language, aptitude/attitude, analytical skills, ability to work independently, ability to think on their feet, self-expression, missionary spirit, motivation, persistence, attention to detail, problem solving ability, communications skills, charm, and good business sense.

"Best Practices" NGO credit organizations rank those attributes differently and tend to rely on a range of selection procedures to identify the best job applicants. Their selection procedures include the following:

FUCEC, Togo: Announce position, evaluate resumes, and offer written test to finalists. High scoring candidates are interviewed by a selection panel and a decision is made on both technical qualification and character of the candidates.

KIE/ISP, Kenya: After the position is announced, candidates are given a three hour exam and an interview. They are scored on a 100 point scale, with a total of 40 possible points for the exam and 60 points for the interview.

Candidates are asked general questions such as how would they organize a wedding party to evaluate their organizational skills and their ability to express themselves. They are then asked why they set up the party the way they did to test their analytical skills and their ability to think on their feet.

ACEP, Senegal: Job candidates are required to pass a through a lengthy preliminary training period. Prospective employees are given a three month training contract during which they will be assigned, for one month each, to three different branch offices. Branch managers evaluate and select the best candidates at the end of three months. ACEP also performs a background check on finalists with past employers.

How Do You Decide Whether to Hire Women?

The basic question isn't whether women can or cannot become successful loan officers, but rather how well can women work in the conservative rural environment where many field agents must operate. Are women listened to in this environment? Is their advice accepted and valued?

An important concern for women field agents is that of transportation. Can they travel between isolated rural villages on their own? Do they need to be able to ride a motorcycle? Can the organization afford to offer them a car? Some organizations which prefer to hire women field agents have found that they cannot because the women don't want to ride motorcycles and they cannot afford to give them cars.

ACEP in Senegal does not use women field agents because of cultural norms that make it extremely difficult for women to work in traditional business settings. ACEP hired several women as field agents but found they not only had problems with gaining respect in traditional village societies, but also had trouble wearing trousers and riding motorbikes.

GCC in South Africa has had problems with its male loan officers spending too much time romancing the daughters of their clients. Female loan officers do not have this problem.

At K-REP in Kenya, the organization's annual performance awards are almost always won by women loan officers. K-REP has never had to fire a woman field officer.

Is Age A Factor In Deciding Who To Hire?

The highest staff turnover rates are among 19-25 year old university graduates. They are often single, have no commitments, and are highly mobile.

The most stable staff members tend to be 35 and older and married with children. This group tends to stay for a longer time and to be more loyal to the organization.

How Much Education Does Your Staff Need?

Because of the difficulties of getting an advanced degree, university graduates tend to think that some types of work is below them. Because of this, university

graduates tend to make better office staff than field staff. Being a loan officer in a rural area is often not stimulating enough for them.

The Grameen Bank in Bangladesh requires that its job applicants have a Masters degree. This may be unrealistic in the African context, but Africa will move towards higher degree requirements as unemployment increases among university graduates. Although university grads currently look down on field work, the worsening economic situation across Africa may force a change in their attitude.

How Do You Track Personnel Performance?

IBEC in South Africa has moved from an individually based evaluation system to a team based evaluation. Branches are evaluated as a whole and compared to other branches on a monthly and yearly basis. Individual performance is evaluated once a year.

KIE/ISP in Kenya has developed a performance appraisal system which evaluates each employee based on criteria such as portfolio growth, recovery rates, their ability to work in a team, their ability to follow directions, client satisfaction, portfolio quality, and profits generated. These criteria are weighted and then totaled to form the basis of the employee's annual evaluation.

In addition to the above mentioned criteria, yearly evaluations also take into account external factors that can positively or negatively affect an employee's performance. These factors can include any or all of the following, with their relative importance determined by individual organizations:

- Area of concentration,
- Density of clients,
- Geographic coverage,
- Quality of staff,
- Client load per staff member/portfolio load per manager,
- Staff training,
- Staff incentive schemes,
- Logistics (transportation),
- Tools for the job,
- Management information systems,
- Management procedures,
- Staff involvement in planning,
- Roles, responsibilities, accountability.

How Do You Achieve Good Staff Development?

Training through participatory workshops is important but not sufficient for staff development. Training needs to be detail oriented. At K-REP, Kenya, all staff attend the credit officer training course. This includes administrative assistants, secretaries, and all other K-REP staff. This system has two distinct benefits: everyone learns what the work of a loan officer is, and during the training K-REP management is able to evaluate the potential of its staff.

Techniques for staff development can include: incentive schemes, training and educational benefits, travel, exchange programs, new equipment, monetary rewards, management respect for staff, and a clear career track with good internal mobility.

How Do You Provide Good Staff Incentives?

Offer your staff clear incentives for successful performance and clear sanctions for unsatisfactory performance. If they build up the portfolio, "the sky is the limit," and they are promoted and receive bonuses in accordance with their performance. If they run down the portfolio they are fired.

If staff incentives are based solely on number of loans per agent, some agents will risk taking on more loans than they can manage effectively in order to maximize their commission. One way to avoid this situation and to ensure that portfolio quality remains consistent with portfolio size is to base commissions for agents on loan interest receipts minus defaults. This system encourages agents to find new clients, drop bad clients and maintain contact with good clients. To avoid punishing good managers who are assigned problem portfolios, their commission can be based on arrears collected not on loan interest receipts.

Incentive schemes can be designed to emphasize the link between the individual agent and the portfolio as a whole. One such system bases individual commissions on the interest on the entire loan portfolio, minus defaults, minus office expenses. This system also creates incentive for everyone in the organization to reduce overhead costs.

Other systems are targeted performance schemes using group incentives. For example, if the repayment rate on the loan portfolio reaches the targeted level of 95% then everyone on staff receives the equivalent of an extra paycheck. For each percentage point above 95%, the staff receives the extra paycheck plus 20%. For example, if the portfolio maintained a 96% repayment rate, staff would receive a bonus equivalent to one paycheck plus 20%, at 97% they would receive one paycheck plus 40%, at 98% one paycheck plus 60%, etc. Conversely, if the portfolio performs at less than 95%, they will receive a bonus of a month's pay less 20%.

Monetary commissions are not the only way to motivate high staff performance. Yearly or monthly performance awards for highest repayment rate and most improved portfolio can also create strong staff motivation. In the case of non-performance, managers or agents whose portfolios are losing money should receive disciplinary notices and a warning to improve their portfolio or risk termination.

III. PROGRAM MANAGEMENT FACTORS TO BE CONSIDERED

How Do You Decide Which Clients to Target?

Only after defining your target group, can you establish appropriate policies and procedures to reach them. You have to know who you are looking to serve. Your target group can have a variety of definitions:

-"The lowest class of economically active people." This definition excludes the "poorest of the poor" as a target group. The poorest of the poor are focused on subsistence and therefore do not run businesses.

-"Target bankable clients who are not currently served by banks and who can't obtain reasonable credit from any other source."

-"Target people not accepted by the formal financial system."

-"Target rural areas not serviced by banks."

You must decide what will form the basis for your targeting criteria. Will you target those who need credit the most (needs based), those who can use it the best (use based), or those who are most likely to pay back their loans (risk based)? The answer to this question depends on your organizational objectives and has an important effect on your organizational structure.

Targeting flows from organizational strategy. For example, if your objective is a self-sustaining loan portfolio, you must target sustainable businesses.

Client targeting is a function of the loan model you select and the amount of loan money you have available. A solidarity loan-based model won't work at the very top of the economic scale, and an individual loan model won't work at the very bottom of the economic scale.

Targeting those excluded from the formal financial system is a good start, but it is not enough. You must define your selection criteria further and look at why they are excluded. Are they excluded because they have no business plan? Because their business is not viable? Because they have no collateral? Because they are illiterate?

Or simply because they are in the informal sector?

There is no sense in trying to find a common definition of target groups. Target groups vary in different organizations, environments and time periods. Even organizations with similar objectives can have different target groups. The important thing is to define your own target group. There is no single right answer to targeting.

How to Stay Informed About the Loan Portfolio?

The "Best Practices" Workshop participants stressed the importance of having rapid access to accurate, comprehensive financial management data so they are always well informed about the performance of their loan portfolio.

There are four general approaches to finding an appropriate management information system:

a.) The least expensive approach is to buy an off-the-shelf system from a software dealer.

b.) Another, slightly more expensive approach is to buy an off-the-shelf system and adapt it to the needs of your organization.

c.) The most expensive approach is to have a program developed for your organization and custom tailored to your information needs.

d.) The fourth approach is to buy computer time on someone else's MIS or to contract out for MIS services. This pay-per-use approach can save money depending on how often you run your MIS and the amount of computer time you need.

Workshop participants have used all of these approaches, with varying degrees of success. The following are the highlights of their discussion regarding the relative advantages and disadvantages of each approach:

Off-the-Shelf Application Packages

Advantages:

-Cheaper ($300-$1,200 range), easily available, easy to install.

Disadvantages:

-It is very difficult to find an off-the-shelf system appropriate to the unique needs of your organization or those of small and micro credit in general. It may be cheaper in the short run to buy an already developed system, but if it does not meet the MIS needs of your organization, it can be costly in the long run.

-You may be buying more or less power than you need and you may have to train staff on a non-user friendly system.

Examples:

-Loan Master; Runs on DOS, can do efficiency measures, age analysis, exposure and risk analysis.

-Peachtree; A standardized accounting application package.

-SBT; Another accounting application package.

Adapting an Off-the-Shelf Application Development Package

Advantages:

-Purchase of a basic package can be inexpensive, but prices range with the level of sophistication from $300 for a simple system to $150,000 for a system powerful enough for a commerical bank.

-Packages can be adapted to suit the unique information needs of your organization.

Disadvanages:

-Though there are inexpensive application development packages, the biggest cost of these packages is in staff time (or contractor time) to adapt them to your organization.

-Off-the-Shelf application development packages may not have the capacity or flexibility to be adapted to your organization's needs.

Examples:

-Dbase; A widely used and inexpensive financial analysis system.

-Knowledgeman; A programmable database which shows loan officer performance and frequency of contact with clients, handles both numerical and non-numerical data. This system can be tailored to the needs of an individual organization through a simple step by step menu-driven self-programming function.

-Paradox; More sophisticated than Knowledgeman. Used by PRIDE/Kenya. PRIDE is happy to share their system with other organizations. It cost about $10,000 over three years to develop and debug.

-Informix R4GL; A highly sophisticated (and expensive) American software package for developing an MIS system. The package is not expensive, but developing and adapting it is. Cost: more than $10,000.

Custom Tailored Systems

Advantages:

-Application system is adapted to the exact MIS needs of your organization.

-Custom tailored systems have high up front costs, but can save an organization from the even greater eventual costs if it loses control of its credit portfolio.

Disadvantages:

-Very expensive in staff time or money to pay an outside consultant to design a system. If a consultant is hired, staff must take time to explain exactly how the organization's accounting and management systems work to the programmer.

-As your organization changes, your MIS system can become outdated. You must then pay for a programmer to come in again and modify the system.

Examples:

-InfoCOOPEC: Developed for FUCEC Togo, runs on DOS. FUCEC is willing to share this technology with interested organizations. Cost: very expensive.

-ACEP MIS: Developed for ACEP Senegal. Cost: very expensive

Contracting Out for MIS Services

Advantages:

-Contracting out, or buying time on somelse's MIS system can be a cheap approach in the short term if your organization does not run its MIS frequently.

Disadvantages:

-Management does not have immediate access to up-to-the-minute MIS data.

-Your organization does not build an internal institutional capacity for MIS.

-If you need frequent updates of your MIS, this approach can be expensive. Over the long term it is probably more expensive than developing internal MIS capacity.

How to Establish Good Feedback Mechanisms?

Field staff need to pass back information to management when things are not working. Sometimes there is a reluctance to inform management of problems. Therefore, management must create a culture which promotes feedback and encourages staff to not keep problems to themselves.

Management should create a variety of mechanisms for staff to pass on information. Feedback should be facilitated through weekly meetings and through regular field visits by management. Management should not distance themselves from staff. They should be on a first name basis with staff and try to see them on an informal basis.

Feedback is not a one way communication loop. Management needs to communicate regularly to staff through guideline memos or through a newsletter. In

a newsletter you can highlight successful projects and personnel, offering positive role models to other employees and the prestige of public recognition to outstanding employees.

How to Guard Against Favoritism by Field Agents?

FUCEC in Togo expects its staff to function effectively wherever they are posted, but generally assigns field agents to an area outside of their home province. It is harder for agents to collect money from friends and relatives or to deal with threats from relatives than it is from strangers.

IBEC in South Africa guards against the risk of favoritism among its field agents through periodic spot checks on their clients. Client portfolios are also occasionally switched between agents so an agent will collect payments and evaluate loans for the clients of a different agent.

What Do You Do About Threats to Field Agents?

For most organizations, physical threats to their staff are a rare occurrence. A borrower who is in arrears will often want to keep the fact that they are in debt a secret and not want to make a fuss so their neighbors find out. However, some organizations serve clients who are located in unsafe areas and must deal with threats as a part of operating in those areas.

ACEP in Senegal instructs agents not to respond to physical threats, but to report them to their branch manager. The branch manager will then visit the

borrower to find out why they threatened the agent. If the borrower is still hostile, the manager will see a lawyer and inform the authorities.

K-REP in Kenya uses a slightly different approach. They instruct their agents to discuss threats directly with their borrowers at solidarity group meetings. They also contact traditional elders and the local authorities to solicit their support and intervention on the part of the threatened agent. K-REP staff visits the area and expresses their concern to the community. If the situation continues, K-REP staff explain the benefits of K-REP's presence in the community, and threaten to withdraw if the threats continue.

GAF in South Africa works in an environment that is violent and highly politicized. If one of their agents is threatened, they approach the community members and explain to them the value of the service they are receiving, promising to pull out if the threats do not stop.

What Relationship Should You Have With Banks?

Some clients have larger credit needs than our organization can handle. These clients are passed on to formal financial institutions who are better equipped to handle larger loans. As a matter of policy, clients should not be restricted from borrowing from banks.

However, if our programs take the risk of lending to informal sector, then we should see the benefit if we find reliable borrowers. Small and micro lending

programs should not fall into the position of doing the donkey work for banks by finding good borrowers, then graduating them to formal financial institutions.

PRIDE/Kenya has well-established relationships with local banks. PRIDE requires that all borrowers have a bank account and helps them to set one up if they do not have one. PRIDE has even negotiated a deal with local banks whereby PRIDE borrowers are allowed to open an account with a balance of only 100 shillings instead of the normal 1,000 shilling opening balance. When PRIDE issues a check for a loan it is made out to the solidarity group and the money is deposited in the individual bank accounts of group members.

Should You Provide Non-financial Services?

There is an on-going debate among SME practitioners about whether or not to offer technical assistance (TA) to their borrowers.

An organization that wants to start providing TA should first ask itself several questions: What it the value of the TA? What is its cost? Does it pay for itself? Does TA increase the security of your loan portfolio? Is TA needed or wanted?

Some organizations say that mixing TA and credit creates a conflict of objectives and doesn't work. They believe and that the two should be separate activities and that TA should only be offered if it can pay for itself (which is rare).

Referring a borrower to another organization which specializes in SME technical assistance is easier and better than trying to provide TA yourself. If you are a banker, stick to banking.

Providing TA to a borrower can create confusion among the staff as to their role. If an organization provides both credit and training, its staff are asked to play the role of both loan officer and trainer. Staff can become confused about whether their primary role is to manage loans or improve the businesses of their borrowers.

Receiving both credit and TA from the same organization can also create questions of loan ownership among borrowers. If an organization tells, or even suggests, to borrowers how to spend their loan money there is a risk that borrowers will think the loan belongs to the lender rather than to themselves. For example, if an organization suggests a specific technology or methodology which latter does not work, the borrower may feel that it was the organization's recommendation that failed, therefore they don't need to pay back the loan.

PRIDE/Kenya has a system to make TA and training more demand responsive. After a borrower has successfully repaid their first loan, they are eligible to purchase coupons for technical assistance which they can then use to buy TA on the open market. For example, after their first loan, a client has the right to buy a 500 shilling TA coupon at the subsidized price of 100 shillings. Some coupons have even been sold to non-PRIDE borrowers at their full market price. PRIDE has recognized the need to have coupons at different and higher price levels to pay for different amounts and kinds of TA.

GAF in South Africa helps its borrowers to reach out to new markets by sponsoring an annual business week which includes a flea market where borrowers can display their products. This flea market not only helps clients to advertise and to

boost sales, but also puts them in touch with suppliers and with other businesses in their field.

How Do You Know You Are Having An Impact?

Impact analysis has two primary goals: to prove that your programs have been successful, and to prove that your programs have created economic growth. Another finance-specific goal is to prove that loans are being repaid and that outflows are equalled by returns. Impact analysis is also important for internal organizational control and for reporting to donors.

The two most common methodologies for impact analysis are: client-level impact analysis, and control group or time series data analysis.

Accurate client-level impact analysis begins with a baseline data survey. Important baseline data can include information on the clients social situation, age, gender, income level, age, type, and size of business, number of employees, etc.

After gathering sufficient baseline data, client impact evaluations should be performed every six months to a year to gather specific information such as whether any new jobs have been created at the firm or whether any jobs have been lost. Generally, the purpose is to determine whether and how the client has benefitted from the loan and what type of further assistance they require. It is important to remember that impact analysis does not always reveal a positive impact.

The analytical process must be tempered with the realization that staff resources are limited and that impact analysis should not be allowed to absorb too

much staff time. Impact analysis should not simply be an academic exercise. It should have a positive programmatic effect.

SECTION TWO

The purpose of the African "Best Practices" Workshop was to bring together the managers of successful NGO credit providing programs to establish a continent-wide, indigenously managed information and experience sharing network.

The vision of what this African network could become and do was articulated by Kimanthi Mutua, Director of the Kenya Rural Enterprise Program (K-REP), who opened the workshop.

I. VISION STATEMENT

On behalf of small and micro-enterprise development agencies in Kenya, the people of Kenya and the Kenya Rural Enterprise Programme (K-REP), I would like to welcome you all to Kenya and to this "Best Practices" workshop.

This workshop, which brings together participants from a number of organizations who have distinguished themselves by their high quality program performance, marks the beginning of a new chapter in small and micro-enterprise development.

It is sad that up to and until now, many of us have paid little attention to the wealth of experience that is available in Africa, and travelled to far countries and continents to learn what they could have learned from a next door neighbor. It is even sadder that the few exchanges that have taken place among programs in Africa, are more often than not initiated by donors ---- simply because we Africans have no knowledge of what resources are available to us from our own continent.

In a recent survey of institutions providing assistance to small and micro-enterprises, my organization (K-REP) listed a total of 86 organizations in Kenya alone. Many of these organizations knew little or nothing about what other organizations were doing and how well. In fact, a number have travelled to far places to learn new technologies, which are being practiced in Africa. Undoubtably, wheels have been and still are being re-invented, efforts duplicated, and many costly mistakes repeated because we have no channels to share experiences.

It gives me a lot of pleasure, therefore, to see many if not all of the most distinguished SME development organizations in Africa getting together for the first time. It is my hope that this is only the beginning and that in the future we will not have to depend on CEC to convene these innovative workshops but will take on that responsibility ourselves.

So what will be the output of this conference and what significance do we hope it will have for improving the performance of our organizations?

I believe that the participants in this workshop, represent a wealth of experience and technical knowledge in SME credit. The shared learning articulated in this workshop will be an initial expression of recommended performance expectations and quality control standards for organizations that provide credit services to poor entrepreneurs.

We are more than qualified to enter into group dialogue for the purpose of distilling from our experience appropriate, performance-based lessons learned and formulating quality control standards to which all other organizations in Africa wishing to excel at providing similar services will be held accountable.

One way of realizing this aspiration, is through the establishment of an African "Best Practices" Association, which would co-ordinate and facilitate sharing of ideas and experiences and formulate appropriate African, context-sensitive, quality control standards for measuring performance. It is important, however, that the organizations involved be committed to the Association and find value in being a member. If this is not the case, then we will be creating just another club, which serves no purpose.

The question then is what would this association do? This question is best answered by the participants after considering what is relevant and important for their organizations. I would therefore, not like to dictate what should be discussed. I would, however, like to suggest the following topics for discussion:

1) Exchange of experiences, particularly in the areas of credit delivery methodology, information systems and impact assessment;

2) Identification of training expertise among the member organizations. (i.e. identify Association members to provide demand-driven training to would-be "best practices" organizations and transfer needed financial management skills and technology);

3) Provision of "best practices" quality control certification to participating organizations. This workshop should also determine how certification would benefit the organizations that it accredits. For example:

- Donors seeking to fund cost-effective and efficient organizations could use the association as a clearinghouse.

- The association could be used to assess the TA and training needs to upgrade service delivery capability among NGOs.

4) Facilitate a network that would identify and access literature on SME development. This network would make its members aware of valuable on-going initiatives in order to avoid re-inventing the wheel.

With these few remarks, I once again welcome you to this workshop, and hope that we will have fruitful discussions which will usher a new era in SME development.

II. THE AFRICAN CREDIT PROVIDERS' ASSOCIATION (ACPA)

The workshop succeeded in fulfilling the expectations articulated in the vision statement. The African Credit Providers' Association (a working title until an official one is selected), is currently drafting a constitution and by-laws.

The workshop elected the following African credit program managers to head the newly formed African Credit Providers' Association (ACPA):

Kodzo Akemakou, FUCEC, Togo to serve as ACPA co-chairman;

Reggie Naidoo, IBEC, South Africa to serve as ACPA co-chairman;

Christine Glover, GCC, South Africa to serve as ACPA secretariat;

C. Aleke Dondo, K-REP, Kenya to serve as a representative; and,

Papa Ali Ndior, ACEP, Senegal to also serve as a representative.

Community Economics Corporation was selected to provide TA.

III. GOALS AND ACTIVITIES OF THE ACPA

Participants in the workshop discussed what the goals and purposes of the newly formed African Credit Providers' Association should be and which activities they plan to initiate in the short term future. Mr. K.E. Wakeford of Group Credit Company's Port Elizabeth office in the Republic of South Africa was selected by the participants to summarize their comments which were later voted on and accepted. The following is the summary Mr. Wakeford made of the concept and need for an ACPA information sharing network and the association's goals, purposes and planned activities:

A key point on which all "Best Practices" Workshop participants agreed is that we do not want to create an association with a big bang, and then have it end up as nothing in two to three months. To avoid this, we decided to start with a small organization, informally linked, but with a formalized management committee. This committee was democratically elected by participant organizations with one member from each region. The committee is composed of the following individuals: Reggie Naidoo of IBEC as chairman, Kodzo Akemakou of FUCEC as co-chairman, with Aleke Dondo of K-REP and Papa Ali Ndior of ACEP as alternate members.

After some discussion about what role of the committee should be, it was decided that logistically we do not have the capacity to fund a formalized institution with its own permanent secretariat. The workshop participants agreed that CEC should facilitate the work of the committee in response to requests from the African members of the association. The development of this association is to be an African owned process and

all consultants assisting the association will be accountable to its members. CEC's consulting role will be reviewed at the end of the year.

The functions of the committee are to be as follows:

-To facilitate national, regional, and continental communications between African "best practices" credit practitioners. This should include evolving NGOs who are identified by member organizations as having the hope of becoming "best practices," but should be focused primarily on interaction between "best practices" organizations which are at a similar stage of development and are working in similar environments. As a first step in facilitating this communication, the committee would like CEC to put together the results of this workshop and distribute them to participants as soon as possible.

-To facilitate an exchange program between ACPA member organizations. This is not to be a visitation program, nor an ideological or philosophical experience sharing. We have all had enough of those kinds of conferences. The exchange program should be a hardworking and responsive exchange of staff members to share detailed, practical experience in the field. Exchanges will be for up to three months, with staff working in the field and being responsible to the organization hosting the exchange.

-To raise funds for the association. The committee will put together a proposal to fund the creation of the ACPA. Each member organization will make a contribution to the association, such as sharing in the rotating responsibility for hosting workshops, to reduce dependency on outside donors.

-To organize focused technical workshops. These workshops should offer participants the chance to talk about nitty gritty details. They should focus on specific

case studies such as portfolio damage control or arrears management. Workshop planning is to begin immediately, with country members and regional representatives offering feedback information on the agenda. The ACPA committee will serve as a central decision making body to develop the agenda and facilitate the workshop.

-To investigate the possibility of bringing in international experts such as Dick Patten or representatives from the BRI in Indonesia to see what kind of cross pollination of experience can take place.

SECTION THREE

CASE STUDIES OF AFRICAN "BEST PRACTICES" CREDIT ORGANIZATIONS

BACKGROUND AND METHODOLOGY

Community Economics Corporation (CEC) has interviewed nine "best practices" organizations which have successfully loaned money to small businesses and low income individuals in the Republic of South Africa (RSA), Kenya, Senegal and Togo.

This research was initiated by CEC in its capacity as small business advisors to the A.I.D. African Region's Office of Operations and New Initiatives, and in response to the expressed need of African program managers. Hopefully, this initiative will foment the development of a network for sharing Africa-specific SME credit insights and will accelerate a continent-wide interdependent learning process to alleviate problems and constraints shared by program managers who, until now, have worked in relative isolation from each other.

It is important to stress that the purpose of CEC's field interviews was not to evaluate nor critically assess these organizations. The purpose is to share their successes, problems, and lessons learned as input to reinforce the newly formed African network for the exchange of small and microenterprise (SME) credit information and experience.

The CEC field team conducted key informant and focus group interviews with the management and key staff members of the following organizations:

- Get Ahead Foundation (RSA)
- Group Credit Company (RSA)
- Independent Business Enrichment Center (RSA)
- Small Enterprise Foundation (RSA)
- Kenya Rural Enterprise Program
- Kenya Industrial Estates/Informal Sector Program
- PRIDE (Kenya)
- ACEP (Senegal); and,
- FUCEC (Togo).

The CEC case studies of these nine African NGOs providing credit services have been organized and presented in the following format:

I. COUNTRY

A. ORGANIZATION

1. ORGANIZATIONAL BACKGROUND

2. PROGRAM SERVICE DELIVERY METHODS

Staff Recruitment/Hiring Criteria and Practices

Client Targeting, Selection Criteria and Screening

Loan Application Design and Implementation

Loan Portfolio Management Policies and Procedures

Non-financial Program Service Delivery

Program Monitoring Procedures

Board of Directors, Composition and Role

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Loan Fund Terms and Conditions

Loan Interest Rate Policies

Loan Disbursement Procedures

Loan Repayment Collection Procedures

Loan Arrearage and Default Practices

Loan Program Accounting Procedures

Role of Commercial Bank(s)

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and Challenges

Significant Accomplishments

Lessons Learned and Recommendations

I. REPUBLIC OF SOUTH AFRICA

A. THE GET AHEAD FOUNDATION (GAF)

1. ORGANIZATIONAL BACKGROUND

The Get Ahead Foundation (GAF) is a black-run non-profit organization, registered as a Section 21 Company with the Registrar of Companies in South Africa. GAF was founded in 1984 and in less than ten years has grown from one office to twenty-one offices throughout the Republic of South Africa.

2. PROGRAM SERVICE DELIVERY METHODS

Staff Recruitment/ Hiring Criteria and Practices

GAF recruits black middle-managers from local banks and private sector companies whose white management structures have traditionally limited advancement opportunities for blacks. As a result of this recruitment strategy, GAF has an almost entirely black management team. It pays competitive salaries and offers its staff a unique opportunity to participate in a serious development effort in the townships.

GAF has been hiring and training loan officers and other office personnel to staff its growing number of offices around the country. GAF field officers have been trained primarily in formation of groups, procedures for collecting savings and loan disbursal. Due to a sharp increase in arrearage over the past year of expanded

lending, GAF has concentrated on preparing field staff for loan follow-up and collection procedures in cases of delinquency.

Client Targeting, Selection Criteria and Screening

GAF targets low-income residents in the black townships. The first groups to be formed were drawn from rotating savings and credit groups known as stokvels. Clients organize into groups and receive small loans of R100 to R1,000 ($33 to $165).

GAF also targets individual loans to middle-income entrepreneurs with loan sizes ranging from R1,000 to R20,000 ($330 to $6,600) and averaging about R5,000 ($1,650). These "business loans" are made to graduates of the stokvel loan program who had performed well.

GAF has recently experimented with franchising their lending program through a community development approach, training selected local community groups (church, civic, educational, etc.) to organize stokvels and act as vehicles for lending.

GAF has recently established a housing division which offers loans ranging from R500 to R10,000 ($165 to $3,300) to people forming stokvels for the purpose of buying building materials to construct houses. A newly hired private sector manager is preparing a lending plan for housing finance. Diversifying into housing finance will require special training for field staff, the formation of separate borrower groups, and the development of new lending policies and procedures. This may eventually lead to the creation of a separate entity to manage housing loans.

Loan Application Design and Implementation

In the stokvel program, the loan application process is one of self-selected group formation and preparation through group training sessions. During this process group members evaluate their peers and decide whether or not to accept each member. Groups are required to save for at last three months or three savings deposits before their loan applications will be considered. Loans are disbursed to and repaid through the democratically elected group leaders. GAF emphasized that it is very important not to rush the group formation process or the disbursement of loans. Group members must know each other well before loans are disbursed or problems tend to develop.

Loan Portfolio Management Policies and Procedures

Since 1984, GAF has expanded from one to twenty-one offices around the country. During this expansion period, GAF concentrated on group formation and the servicing and monitoring of loans received less attention, with the result that repayment levels fell from 91% in 1990-1991 to 83% in 1991-1992.

Realizing the gravity of this problem, GAF has responded by focusing substantial effort on loan monitoring and follow-up. The number of new group loans has decreased and new individual loans are no longer being made at this time. A tough new policy has been established whereby delinquencies are handed over to collection agencies, and bad faith cases are taken to court. Field officers will also be given improved training in screening, selection and loan preparation techniques to

improve the quality of the portfolio. Through these policies, GAF is seeking to re-establish its image as a serious lender, rather than a "soft NGO" with grant funds to disburse in the townships.

Non-Financial Program Service Delivery

GAF has provided marketing assistance to some clients through a range of programs. These include sponsoring trade fairs in the townships, linking external assistance directly to high growth firms, promoting sub-contracting between large enterprises and small business. GAF has published a "Resource Directory" for its clients and a "Directory of Black Businesses" for formal sector businesses. GAF is also experimenting with organizing clients with shared needs into buyers cooperatives.

GAF managers are concerned about the low educational level of their target beneficiaries and laws which effectively excluded blacks from accesses to business opportunities. GAF has a three step training program through which illiterate and semi-literate borrowers are given literacy training followed by basic business training, after which they can apply for small business loans.

GAF also runs a "winter schools" program and has organized training and technical assistance sessions in the townships to teach basic business skills in such subjects as bookkeeping, marketing, management, and costing. Through its loan officers and external mentors, GAF also provides on-site business advice to clients.

Program Monitoring Procedures

GAF has grown exponentially in the last several years, significantly improving its loan administration, monitoring systems, loan disbursement and collection systems. GAF pursues defaulters vigorously, using the legal sustem and collateral repossession to recover defaulted loans.

GAF estimates that its branch office portfolio management break-even point is 150 stokvels per loan officer. Competition among loan officers to reach these client service targets has been intense and results are tracked by area statistics published in GAF's monthly newsletter.

Board of Directors, Composition and Role

GAF has a nine member board that includes its general manager, operating manager and well known leaders of the black community. On both financial and political fronts, the board has been highly effective in opening doors to expand GAF's programs.

Thanks to the support of its board of directors, GAF was able to successfully establish a fund raising office in the U.S. GAF has also received funding from a number of donor governments, multinational corporations, and affiliates or subsidiaries of multinational corporations in South Africa. GAF has mobilized additional financial support (mainly grants) from U.S., Canadian, and European foundations.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Loan Fund Terms and Conditions

GAF's 1991 annual report shows that donations comprised 90% of its total revenue for the year and have increased by 73% over 1990. Management did not discuss plans to access financing mechanisms from formal financial institutions to carry out its stokvel lending scheme.

Stokvel loans carry a 36% interest rate and contributed 8% and 7% to GAF's total revenue. The lending fund increased 30% between 1990 and 1991, and the loans outstanding went up by 130% in the same time period. Donations from outside funders facilitated this relatively heavy lending activity. As an additional, albeit small, source of revenue, GAF invests the savings from the stokvels in whatever amount exceeds that needed to guarantee a group's loan.

According to the annual report, the cost of lending one Rand in the stokvel program is R0.25, while the cost of lending one Rand in the business loans program is R0.08. Administrative costs are 15% of overall costs. Operational costs far outweigh revenues. Loan revenue in 1991 amounted to 16% of administrative costs which was down almost 9% from 1990.

Loan Interest Rate Policies

GAF charges an effective 36% annual interest on its stokvel loans, which is about 17% to 20% above inflation. However, when clients pay back on time every

month they receive a 10% rebate on their payment, which then reduces it to 26%. The majority of GAF's borrowers have good repayment records and qualify for that reduced payment rate. GAF feels that this rate reflects the risk of lending to the clientele it has chosen to serve, namely black township dwellers and the very poor. GAF charges no fees on a loan, nor does it charge for business training services and other technical assistance.

Loan Disbursement Procedures

GAF has recently modified its loan disbursement system. Formerly, the GAF head office cut a check to a stokvel for the amount corresponding to the total eligibility among its members. The checks were made out to groups, but sent to loan officers. Loan officers gave the check to group leaders who deposit the check in the bank after securing endorsements from members of their group.

The intention was that each member would go to the bank and draw down his or her portion of the deposit. However, group leaders would often make withdrawals for group members because they were uncomfortable dealing with the bank. This system was vulnerable to abuse because loan officers or group leaders could forge checks or skim off of loan withdrawals or deposits.

To reduce this risk, GAF now makes out checks to individual members of the stokvel and deposits them into their individual accounts. GAF is considering electronic funds transfers to promote greater uniformity in disbursal and repayment.

They have been held back in this approach because Standard Bank, through which GAF does most of its transactions, cannot do electronic funds transfers at this level.

GAF has investigated grouping borrowers by sector (i.e. panel beaters, welders, carpenters, etc.). Management suggested that disbursing loans by sector could smooth payment streams and facilitate tracking. Advantages in economies of scale, wholesale buying agreements, matchmaker exhibitions, and sub-contracting could accrue to borrowers grouped according to their types of businesses.

Loan Repayment Collection Procedures

GAF depends upon character references and group pressure to ensure loan repayment in its stokvel loan program. The groups are self-selected and loan repayments are made monthly, with each group deciding on their repayment date.

Group leaders collect the cash from members, and make a deposit into the area bank account. They give the deposit slips to field workers who pass records and receipts to the loan officers, credit officers, and the head office. It is the responsibility of the stokvels to hold meetings and collect money.

In most cases, borrowers in the business loan program are graduates of the stokvel program. Loans are made to individuals on the basis of the client's record with GAF and an assessment of business viability. Clients make their payments directly to the banks.

Until recently, borrowers in the stokvel loan program did not have direct contact with commercial banks. Their savings deposits and loan repayments are now

handled through stokvel group leaders and GAF field personnel. Borrowers have individual accounts within GAF, but bank accounts are kept at GAF offices.

GAF field offices maintain Cash Books to record the repayments of each stokvel in their regions. The Cash Book and the Savings Book are the record keeping and monitoring tools through which repayments and savings are tracked.

Loan Arrearage and Default Practices

GAF has adopted a "get tough" approach to defaulting borrowers. At the first non-payment, GAF depends upon the group to pressure borrowers who fail to make a scheduled payment and the field worker issues a friendly reminder. If the borrower does not pay after this, a letter is sent threatening legal action and public embarrassment.

Failure to respond at this juncture triggers seizure of the borrower's savings and assets and referral to an outside collection agency. In the absence of sufficient savings, assets and/or when the collection agency fails to recover the funds, GAF will file a civil suit.

The audited financial statements in the annual report show an overall recovery rate of 91%, with individual office performance ranging from 69% to 126%. The loan recovery calculation is expressed as a percentage of the money due at the end of the fiscal year.

Loan Program Accounting Procedures

Until January of 1992, none of the field offices submitted regular reports to headquarters. Since then, a new administrative system has been implemented. By the 15th of each month, each office is expected to submit a cash receipts register, a repayment schedule, and an aging report for the previous month's activity. The Cash Book, the Savings Book, and the Stokvel Record Book are the primary inputs for this report. Field officers keep all records by hand. These data are entered into spreadsheets at headquarters, where both shadow records and analysis reports are generated.

Management feels that it must complete an analysis of individual borrower aging before GAF expands further. GAF needs information at the individual borrower level on a not-more-than-two-day-delay basis. A report which generates portfolio at-risk figures is also needed. Data should be arranged to compare planned versus actual risk at the regional level and on a monthly basis at the field officer level. The appropriate software would produce these reports from one management information system (MIS) database. GAF sees enhanced MIS both as a necessary component to monitoring its program and as a cost reduction tool to accomplish more efficient management through better and more timely information.

Role of Commercial Banks

GAF's most direct involvement with formal financial institutions has been a no risk line of credit offered by Standard Bank to the business loans program. The bank had a 100% guarantee fund, comprised of donor funds and pledged borrower savings.

In addition to interest rate charges by the bank, GAF charges a one-time 10% fee up front on the total amount of the loan. GAF provides an up-front assessment of the borrower and is entirely responsible for loan monitoring.

Currently the only commercial bank involvement with the stokvel program is as a repository for loan disbursements, repayments, and savings.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and Challenges

- GAF had an arrangement with Standard Bank to send loan repayment delinquency notices to its clients. This was not done promptly and the result was clients could take a 30 to 60 day "holiday" from repayment. This reinforced the tendency of others not to pay promptly because of the perception that no action was taken against borrowers in arrears. In other cases, clients made payments but the bank's monitoring system listed them as in arrears. This strained GAF's credibility with borrowers accused of non-payment on the basis of wrong information.
- Earlier loans to stokvel groups were made "indiscriminately on the basis of need" (rather than business feasibility). GAF is currently researching what percentage of these less rigorously

analyzed stokvel groups are no longer in business. Although some of these old groups have created problems, new groups "are not that much of a problem" for GAF loan officers.

- Screening of both groups and individuals was identified as a major problem. There is a need to improve monitoring follow-up to learn if businesses which received loans are progressing or getting worse. GAF cannot provide timely technical assistance if it does not know about a problem until it is too late. There is also a need for better baseline data on the motivation and expectations of loan group members.
- Another problem is how to cope with family members who refuse disclose the whereabouts of borrowers who go to squatter areas or other townships to avoid paying their loans. Tracing and chasing defaulted borrowers is highly time consuming and frustrating.
- In some cases loan officers do not adequately verify the composition of a stokvel group. Illegitimate groups are sometimes formed when two friends who want credit recruit three acquaintances in order to qualify as a five member group. These stokvels are not based on a peer group relationship and are prone to default.

- GAF is under pressure to make more loans from stokvels who want to participate in the loan program and from donors to use available grant monies. This pressure can lead to issuing loans without sufficient verification.
- RSA companies are reluctant to sign sub-contracts with small firms because they question the quality and reliability of their work. GAF began a vocational training project in January of 1992 to cope with this long-standing problem.
- GAF faces a unique set of problems which stem from the socio-economic and political conditions currently prevailing in the RSA. In addition to political tension and violence, these problems include:
- The municipalities have over-regulated vendor laws. RSA uses the same business registration form for small hawkers that it does for major corporations. Tthere is also an entire series of laws regulating how often a hawker must change location, and what is a "morally indefensible" kiosk size, shape, and distance from the curb. This over-regulation has caused GAF to "operate illegally" by encouraging civil disobedience by vendors to speed reforms.

Significant Accomplishments

- On the basis of an informal field survey, a GAF loan program supervisor reports that in the 15 months since March of 1991, approximately 1,500 jobs are being created each month as a result of GAF loans, 90% of which will be sustainable.
- One of the groups receiving credit from GAF has successfully operated a consumer credit program which sells inexpensive food items to its members through volume buying discounts.
- GAF's vocational program is making progress in improving the performance of its welders so they can meet the subcontracting requirements of Nestles on a regular basis. Quality control problems have not been entirely solved, but this new program shows promise.

Lessons Learned and Recommendations

- GAF has learned several lessons from operating in an ambience where frequent incidents of violence have become a fact of life. Do not give loans to migratory laborers who are living in hostels because they are transient and exposed to higher than average levels of violence. Do not fund taxis because many have been destroyed as a result of violent battles over access to choice routes and locations.

- Follow-up information on the viability of clients' business ventures is essential to avoid arrearages and defaults. Defaults must be dealt with firmly or they will result in a domino effect which can cause other borrowers to refuse to pay.
- Make financial and programmatic monitoring a top priority because it is essential to loan fund viability and program sustainability.
- Prior to offering business training, certify the literacy level of participants, especially if formal rather than informal techniques are used. Remedial training should be provided where deemed necessary.
- Do a market analysis to determine if adequate demand exists for a business's goods and/or services before making a loan.

B. GROUP CREDIT COMPANY (GCC)

1. ORGANIZATIONAL BACKGROUND

The Group Credit Company (GCC) is a non-profit corporation (Section 21 status) located in Cape Town, which has been in operation for three years. It is currently in the process of expanding to Port Elizabeth in the East Cape Region. GCC is a small specialized lending organization which lends, at commercial rates, exclusively for upgrading of housing. GCC became independent of its parent organization (the Urban Foundation) in November of 1992. It currently receives funding from the Finance Corporation, Ltd. (FC), a subsidiary of the Independent Development Trust (IDT), and is seeking to diversify its funding sources.

GCC has a staff of 45, including a general manager, senior finance manager, administrative supervisor, training officer, and a regional manager for each office. Direct program oversight and implementation is done by the two regional managers with 4 supervisors and 24 loan officers responsible for groups which average 15 members each. GCC's growth target is for each loan officer to manage 40 groups.

GCC has made involvement of the formal financial community a key element of its operational and strategic planning. All of its loan funds are on commercial terms with either the IDT-FC or one of RSA's four major commercial banks. GCC is seeking to expand its institutional relationships with merchant banks to diversify its funding portfolio, better match asset and liability terms, and expand its capital base. Donor funds are used for start up, loan reserves, and other non-recurring costs.

2. PROGRAM SERVICE DELIVERY METHODS

The GCC has adopted the group method of lending, but intends to expand its portfolio to individual loans. Its cadre of loan officers act as a bridge between borrowers groups in the townships and the GCC in Cape Town.

Staff Recruitment/ Hiring Criteria and Practices

Due to rapid growth, GCC has significantly expanded the small team that started the organization just three years ago. The founder and general manager came from the Urban Foundation of RSA, an NGO concerned with housing and urban services. She believes strongly that GCC should follow market principles and discipline as the basis for growth. The majority of the management team and the board of directors have strong private sector experience. As a result, GCC has developed a unique combination of a private sector focus on financial self-sufficiency with a commitment to and market knowledge of the lower income housing market in the townships.

Some important staff recruitment and selection policies are:

- Computer literacy is required for all non-field staff.
- Recruit men and women over 30 with the maturity to handle stress and the requirements of the job.
- Select qualified high school graduates for whom the loan officer position represents a major step up.

- Do not recruit college graduates because their expectations are too high to be a loan officer.

GCC has successfully recruited loan officers from among its own clients, particularly those clients that show strong skills at group organization, management, and responsibility.

Key staff compensation practices are:

- Pay competitive salaries in order to draw highly qualified individuals.
- Offer financial incentives for exceptional performance, use in-kind payments which increase staff net income without increasing their tax burden.

Key staff training practices are:

- New field staff are given an extensive 3 to 4 month training program that is divided equally between in-service and classroom training.
- Be aware of the time it takes to develop a good loan officer and the need for increasing these officers' skills in group dynamics and conflict resolution.
- As the loan program matures, it must relate to groups of various stages, ages, qualities, etc. Staff training must help loan officers recognize and deal with these variations.

Client Targeting, Selection Criteria and Screening

GCC has targeted low-income blacks in the townships who own homes and want loans to improve them. The program began by offering R5,000 individual loans with up to five years to repay. At current exchange rates the loan ceiling is about $1,650 per client. The selection and screening process is designed to ensure that the borrower is serious about and capable of repaying the loan and that they are a stable member of the community.

Loan screening is done through the borrower groups. Most groups are self-selected and form on their own to take advantage of this loan opportunity. The average group size is 15 members. A GCC field officer is put in charge of developing and screening the group. Each group is required to start saving as the first step in the loan process, and to build a savings balance for subsequent lending to other members. GCC has concluded that each loan officer can manage a portfolio of 40 groups with an average of 15 members each. Management uses these figures as the basis for planning growth.

During the preparatory process the group must attend 10 workshops which cover subjects such as group formation and operation, loan requirements, procedures, and related financial aspects. This series of workshops usually is carried out in the community where members live. Workshops take place on a rotating basis in the homes of the members to verify that members actulally do own their own homes. Over the period of the workshops, usually covering 2 to 3 months, the loan officer is analyzes the group and its members. GCC considers the quality of the groups as critical to the success of its loan program.

GCC has tried to stay away from squatter settlements which are under threat of removal or political upheaval. It does, however, lend in established, stable squatter areas.

GCC is considering expanding the target population of its program to lower its risk, increase the volume and average size of loans, and move quickly to financial self-sufficiency. These new target populations include middle class township clients who could borrow up to R15,000 ($4,950) for upgrading and purchasing a small house and lower to middle-income groups who can make loan payments through direct salary deductions.

Loan Application Design and Implementation

A new borrowers group must build a savings balance during the 2 to 3 month period of training and orientation workshops. In the past, formal credit checks were not done for individual clients due to lack of information and the high cost of such investigations. This created problems for GCC because groups tend to over-lend to their members. To avoid this, GCC will begin to undertake credit investigations for individual clients.

The loan process and the borrowers groups are set up to generate positive lending behavior. GCC works hard to project an image of seriousness and professionalism like a bank or finance company so clients do not mistake them for a "soft NGO."

Groups can only borrow a percentage of their savings. The group's borrowing limit cannot be withdrawn all at once. Withdrawal amounts are restricted to only a third at a time on three separate occasions. The group must decide which of its members gets each advance of loan funds. If repayment by the group becomes delinquent, no further advances are made until arrears are cleared up and an additional waiting period has been completed. In addition, the group's savings are blocked as security as long as a loan balance is outstanding.

Due to poor economic conditions, arrears have recently grown from less than 1% to about 3%. GCC reports that arrears usually increase after the group's loan limit has been reached and while outstanding loan balances are greater than the savings balance that secures them. GCC is considering shortening the loan term from five to three years to decrease this risk.

In addition to the group pressure, GCC requires each borrower in the group to prepare a loan application, open an account at the Permanent Building Society (The Perm), and provide an individual such as a family member (but not another borrower) as a co-signer/ guarantor for the loan. This gives both group representatives and GCC loan officers a second person to pressure for payment when arrears occur.

Due to the youth of GCC and the medium/long term of these loans, GCC has had very limited experience with follow-up loans for group members or with long term group relationships.

Loan Portfolio Management Policies and Procedures

GCC management and board of directors are concerned about how manage the growth of their loan portfolio. Based on its experience with financial modeling, GCC's management has developed various scenarios for the future. Decreasing loan terms to an average of three years and changing risk levels are potential scenarios.

GCC is also considering diversifying its product mix. One option is employer based loans, where GCC would lend to individuals and then collect repayment through draw-downs on the person's salary. Another product would be targeting individual loans to a slightly higher socio-economic level where risks are perceived to be lower.

GCC is currently expanding by duplicating the successful operating structure of the Western Cape office by establishing an Eastern Cape regional office. The same portfolio development and management techniques will be used for each office.

Non-Financial Program Service Delivery

GCC has not provided technical assistance to groups or individuals for housing upgrading. They have restricted their role to lending.

Program Monitoring Procedures

At present, GCC is concentrating on developing an effective system to monitor and manage arrears. Through The Perm, GCC has a real time on-line system to follow client accounts and has developed reports to monitor the portfolio. They are developing a "red flag" or early warning system which will identify problem group members to minimize arrears and damage to the group. GCC has a hard-nosed follow-up system for chronic delinquents and bad faith cases but they are developing additional preventative methods.

GCC has developed accounting and monitoring systems appropriate to its own needs. They have a PC-based monitoring and reporting system which includes managerial and operational information. They have also designed a system to monitor progress by loan officer so each loan officer's portfolio can be analyzed separately.

Board of Directors, Composition and Role

The board of directors of the GCC has twelve members. Its chairman is from the Urban Foundation, GCC's institutional founder. One board member comes from each of the four major RSA banks, and two members come from the Independent Development Trust-Finance Corporation (the IDT-FC, is a newly formed unit of the IDT to provide wholesale financing for low income housing retailers). Each of the major institutions represented on the board has contributed resources to GCC in the form of credit lines for on-lending funds, initial grants, or loan capital.

The executive subcommittee of the board is composed of five individuals and oversees all GCC's operations. It has provided the top management with continual guidance during the early years of growth, and served as a sounding board for new ideas. GCC management noted the importance of getting advice from experienced bankers, and is considering expanding the board to include high level individuals from the commercial sector with experience in similar credit and commercial operations.

The board is also a vehicle for creating links with sources of financial support such as banks and other financial institutions. Diversifying funding sources increases GCC's independence and opens channels to different types of finance which can increase GCC's flexibility and capability.

Many large companies in RSA have realized that they will increasingly have to compete in the large black township market. GCC's specialization in this market increases their interest in association with GCC.

GCC has also noted it is not in their interest to have exclusive individual institutional backers, such as the IDT-FC or the Development Bank of South Africa, which may want to control the organization. This is particularly true for public sector institutions who have very different agendas than GCC.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Loan Fund Terms and Conditions

GCC currently receives most of its credit funds from an IDT-FC line of credit for 73 million Rand at 18% interest. GCC also has other lines of credit totaling R20 million on commercial terms from NedBank, Standard Trust, and First National of South Africa. GCC's financial advisors agree that a debt to equity ratio of 4:1 is achievable and desirable. One of GCC's main strategic goals is to diversify the organization's funding base in order to mitigate financial risk, move toward self-sustainability, and reduce its institutional dependence. GCC will seek primarily commercial bank financing, which is preferable because the financing terms and interest rates yield are more flexible.

GCC is building up reserves (approximate equivalent to equity) to act as an alternative funding source or as collateral. However, they want to avoid income taxes and retain their non-profit, non-taxable designation for donations.

Loan Interest Rate Policies

GCC charges a market interest rate of 32% on all loans. Currently the term is five years, however GCC is reducing loan terms to three years. GCC has that found clients are less likely to remain committed to a five-year repayment period and that they can afford the higher monthly repayments of shorter term loans. GCC's experience has indicated the best groups repay early to facilitate access to more loan money. Borrowers receive a 4% rebate on their loan as an incentive award for timely repayment of the loan.

Group savings are held in interest bearing savings book accounts with the interest rate depending on the size of the deposit. Groups receive from 4% to 9% interest on their savings. Groups cannot withdraw funds from their savings account unless the group has paid its loan and is disbanding or a member has paid his or her loan in full and is leaving. These members may reclaim their savings with interest. GCC is investigating the possibility of moving member savings to a higher yielding financial instrument.

Loan Disbursement Procedures

Groups of up to fifteen people can become eligible for loans after attending ten training sessions. After completion of the sessions and fulfillment of the savings requirement, groups are eligible for their first loan advance. This cannot be more than 1/3 of the total loan or four times their savings whichever is less. The group decides which of its members will receive loan money and in what order.

Loan Repayment Collection Procedures

GCC clients make individual loan repayments directly to their own bank accounts at The Perm. Borrowers are issued receipt books which allow them to track their progress in paying off the loan. Local Perm branch personnel have been instructed in how to handle these accounts and are familiar with GCC's clientele because of The Perm's previous experience with stokvel group accounts. Payments

are made on a monthly basis, although some groups meet more often to collect repayment and receive technical assistance.

Loan Arrearage and Default Practices

Collections have become GCC's top priority for this year. After a first year of arrearages below 1%, the rate has gone to nearly 3%. GCC attributes this increase to the high risk profile of its borrowers and feels it is symptomatic of the general downturn in RSA's economy. Loan losses among formal banks and other institutions which offer credit in the retail market (i.e., department stores, furniture stores, etc.) have recently risen to 30% to 40%.

GCC has made an explicit policy of publicly notifying and tracking delinquent borrowers. Loan officers make personal visits to clients' homes, question group members, and involve local leaders when appropriate. They have used large stickers, marking houses as inhabited by people with bad debts, to encourage repayment of delinquent accounts. Group savings are frozen during loan collection and are seized if GCC cannot recover its money.

Loan Program Accounting Procedures and Reports

From GCC's inception, it has considered state of the art computer systems to be essential for success. GCC has an on-line real time branch input and inquiry system with The Perm which provides accurate, timely information on client repayment and saving behavior. GCC has also developed an in-house PC-based

monitoring and reporting system which allows tracking of clients and loan officers in a wide array of key performance indicators. In addition, GCC has the sophisticated hardware and software to produce ad hoc reports and forecasts.

GCC in Cape Town has been designated as an acting branch of The Perm, which means it can open and close accounts, transfer funds, alter the status of accounts (e.g., freeze a delinquent account), and access all account information. Such a mechanism yields several benefits. It removes the need to handle cash by anyone outside of the bank. Account information can be entered more quickly and efficiently, and monitoring of loan payments and savings status is virtually instantaneous. This system provides GCC administrative and operational personnel with easy access to accurate and complete accounts information within a 24 hour delay.

GCC runs an internal PC-based monitoring system on Knowledgeman. They hired a local computer consultant to design an MIS system to their specifications. Data input from daily bank reports, monthly bank reports, and loan officer reports from the field is done manually. Data on loan repayment performance and eligibility can be tracked by loan officer, group, region, area, type of loan, or other variables. Most of the reports are produced on a monthly basis.

Five key financial reports are produced on the Knowledgeman system:

- **Variance History**;
- **Arrears History**, which shows a monthly trend of arrears expressed as a percentage of debtor's outstanding loan balance;

- **Balance of Groups in Arrears**, which shows the percentage of a particular group's loan balance in arrears;
- **Number of Groups in Arrears**, which shows the total number of groups in arrears as a percentage of the total number of groups in the program;
- **Number of Times in Arrears by Debtor Group.**

The Knowledgeman system also analyzes borrower group performance and flags group eligibility for new loans. One key performance report is the "Not Eligible" Report. Clients appear on this report for two reasons: fewer than five months have passed since the group last was in arrears, or the group has less than the 25% required savings. Other performance classifications include "Locked," which means that a group is more than 60 days in arrears, and "Pending" which designates groups that loan officers feel deserve special monitoring, even if their repayment record may be up to date. Neither of these groups are eligible for further loans. An "Active" classification indicates that group repayment performance is good and the loan officer has not reported any other problems. Only borrowers classified as "Active" are eligible for further loans.

GCC keeps track of the following repayment variables in order to analyze trends in arrears:

- Loan interest rate to borrowers;
- Cost of funds to GCC;
- Term mix to borrowers and from lenders;

- The rate at which borrowers return for further loans;
- Average loan size, percent of deposit;
- The inflation rate for the country and GCC's market;
- Overhead allocation;
- Loan officer workload in terms of groups and clients;
- Lead time to full load for loan officers;
- Number of people in a group; and
- Product mix.

GCC charges interest on declining balances. Therefore, it must manage its loan and financing portfolios so that peaks and valleys in earnings are leveled as much as possible and financing costs run parallel to the earnings stream.

GCC has determined that it can achieve and maintain financial viability at 40 groups of 15 people per loan officer. GCC has found that the 15 person group size is not ideal for operational purposes, it continues to study how to best serve its client groups while reaching the scale necessary to acheive financial stability.

Role of Commercial Banks

Commercial banks and other formal financial institutions are integral to GCC's financial sustainability strategy. They are considered a necessary and desirable alternative to donor funds. Support from commercial banks has been largely based on GCC's excellent track record. Recognizing that GCC's market represents an area in

which they have no experience, South African banks look to GCC as an important bridge to a market in which they will eventually have to compete.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and Challenges

- A more effective training program needs to be developed for loan officers who are currently strong in human interaction/communication skills but need a better understanding of group dynamics. Loan officers need to understand of the psychology of individuals and groups in order to create incentives for repayment rather than relying solely on threats.
- GCC needs to improve its ability to manage a growing number of staff and clients in order to avoid becoming financially and/or managerially over-extended.
- It is critical to improve GCC's monitoring capability for loan repayment and group performance trends as well as the financial management capability of loan officers.
- GCC needs to further refine staff hiring criteria in order to meet high performance expectations more quickly and sustainably. In

some cases, staff development has proven to be protracted and difficult.

- GCC needs to develop a more diversified mix of funding instruments, packages and approaches to better respond to market opportunities and constraints, generate more revenue, and reduce dependency on any one funding source.
- GCC's current financial viability was described as "wafer thin." There is a need to examine the potential for cross subsidizing some programs and expanding profit margins on others. Related financial issues include the high up-front costs of expanding to new regions, establishing a viable debt-equity ratio, and deciding when to write bad debts off the books.
- GCC is experiencing some tracing problems with clients who move away from the group area to avoid payment when their loan is in arrears. Poor people in these communities are highly mobile and can go to townships in other cities, return to their homelands or blend into squatter communities where they are more difficult to find. GCC is forced to rely on family members and members of their loan group to help locate them.

Significant Accomplishments

- Management feels "incredibly positive" about the results of its effort to create staff development policies which give people "space to grow." These policies include paying generous market level salaries. Staff can earn an additional percentage of their base salary as a performance-based incentive and a discretionary "thirteenth month" salary bonus.

  Incentive awards are given in the form of vouchers which can be redeemed at local stores because additional income would be taxable. For example, awards are given to the loan officers who collect the most money, collect the most from accounts 90 days in arrears, and receive payments from the largest number of groups.

- Management feels it has received positive results from hiring an organizational psychologist to build the field staff's self-confidence, facilitate team building, help cope with job related stress, and improve conflict resolution skills.

  Management sees this as "a pressure release valve" for staff who must face borrowers who are sometime hostile and aggressive when confronted about overdue payments. In some cases, field workers are exposed to violence while working in low income areas.

- Management feels good about "getting our management information systems right" to be able to provide rapid information on loan repayment performance. However, there is "an on-going learning curve" on client selection, adjusting interest rates, and early warning signs of problematical group dynamics.
- GCC loan officers have developed innovative approaches to focus peer pressure on group members who have long term arrearages and appear unwilling to make repayments. In some cases they affix stickers to their front doors informing everyone that they do not pay their debts.
- Management also feels good about its ability to select members of its board of directors who have commercial expertise or are "good financial mechanics." They ask tough questions and have sufficient influence to get key decision-makers to take their phone calls.

Lessons Learned and Recommendations

- Select board members who don't have vested interests in GCC in terms of "baggage" (competing agendas) from their organizations and are able to focus exclusively on making decisions for the benefit of GCC.

- Handle change with care by "plotting and planning" exceedingly carefully to get the atmosphere right and build the confidence required to accept a higher level of risk.
- Computerize early with the best hard and software (prepared for the organization's specific needs) available. Computers should be user-friendly both for inputs and report generation. Do not use a manual systems because this builds an organizational culture of people who think manually and are difficult to retrain.
- Choose an accounting package and monitoring system capable of asking hard questions such as "what's happening, what if, and what then." Monitoring systems should provide instant access to data on arrearages and monthly data on staff productivity, group payment patterns, attendance at meetings, effectiveness of collection tactics, and eligibility for second and third loans.
- Develop an effective system for monitoring loan officer performance. When learning gaps are identified, use competency based training geared to specific problem-solving skills.
- "Never ever" allow your organization to get a "soft and soggy NGO image." The image projected of your corporate culture must be one of a "tough minded money lender" with a commercial orientation. "Debt collection is survival." Because

credit programs are "rumor driven," you cannot allow clients to form the impression that you do not insist on repayment.

- Have a clear understanding of what business you are in (getting money out and back) and what the consequences are of not doing that well. Remember "it's expensive money, don't waste it."
- Clients need to understand the nature of credit and why they have to repay loans. You can start this process by helping them to open a bank account and learn deposit procedures.
- Speak directly to the staff so they understand what is expected of them. Insist on high performance standards and "monitor them intensely" to see that you get it.
- Where practical use women field officers. Men are more inclined "to sow wild oats" or become involved in politics.
- GCC recommends hiring people who are literate and are either numerate or are not "scared of numbers." Employees do not have to be able to calculate the interest on a declining balance, but they do have to understand basic bookkeeping. Loan officers need strong communication skills and a certain level of charm. They also need to be able to negotiate and mediate disputes by thinking on their feet.

- GCC recommends recruiting loan officers from your loan clients on the basis of personal responsibility and ability to handle members of a group.

C. INDEPENDENT BUSINESS ENRICHMENT CENTER (IBEC)

1. ORGANIZATIONAL BACKGROUND

The Independent Business Enrichment Center (IBEC) has been operating since July 1990 in the East London area of RSA. The unemployment rate among blacks in East London is currently 70% to 80%. IBEC's goal is it to promote employment creation and enterprise growth through providing individual loans to small businessmen and women.

IBEC provides finance in the informal sector to those who cannot otherwise find credit. IBEC wants to help these businesses become formalized by paying taxes, having books audited, and moving to the Central Business District of East London.

IBEC's initial loans average 2,000 Rands (U.S. $660) with repayment periods of nine to ten months at commercial bank interest rates. Eighty percent of the 400 loans made by IBEC have been to women involved in retail sales and services. A total of 85% of IBEC's loans have been to women. Only 20% of IBEC's loans were made to the manufacturing sector (primarily to women sewing clothes). IBEC would like to stimulate more manufacturing enterprises through loans in its target areas. Increasing the size of its manufacturing loan portfolio is one component of IBEC's plan to reach 8,000 loans over 4 years.

2. PROGRAM SERVICE DELIVERY METHODS

Staff Recruitment/Hiring Criteria and Practices

IBEC is committed to creating a serious business image for its staff and its clients. It does not want to be seen as a "soft NGO." As a result, IBEC recruits staff with experience in a profit making or market oriented organization.

IBEC considers discipline and company loyalty to be very important. They recruit individuals who are committed to the goals and the financial survival of IBEC and who see IBEC's growth as an opportunity for themselves. Hiring criteria for field personnel include a level of maturity and experience that allows them to relate to their clients and an ability to work in the black townships with small enterprises.

Staff are given a clear set of objectives, a system to follow, management supervision, and support. IBEC offers incentives to reward high level performance and threatens job loss if minimal performance standards are not achieved. For example, if repayment for their portfolio falls below 80%, a loan officer losses his/her job.

Client Targeting, Selection Criteria and Screening

IBEC knows that the vast majority of businesses in the townships have no access to loans through the formal credit system, business education, nor technical assistance. Because most businesses in the townships are small or micro-enterprises (SMEs), they are eligible to apply for assistance from IBEC.

IBEC selects its borrowers from the large pool of eligible SMEs in the following way:

- IBEC field officers screen potential borrowers at the site of their businesses. The business is verified by IBEC staff and a character analysis of the borrower is done by the field officer.
- A simple business plan is prepared with the help of the field officer.
- Attendance is required at a two-day orientation which includes an introduction to business planning, cash flow analysis, introduction to credit and banking, and responsibilities associated with recieving credit from the IBEC program. After this training, trainees are tested. Those who pass are eligible for loans and those who fail are allowed to take the test again.

Loan Application Design and Implementation

IBEC uses a simple information collection sheet which the potential applicant fills in with the field officer as its loan application form. This form functions as a simplified business plan and cash flow sheet which helps the borrower and the field officer identify whether the business needs a loan, and how much money is neccessary. It also helps IBEC to track the loan after it is disbursed. Loan amounts are not pre-set, but vary according to the applicant's repayment capability and the needs of their business. After completing a site visit and helping the potential borrower fill in the application form, the field officer decides whether to recommend a loan to his/her superior who has the final decision to approve or refuse the loan.

The application process is designed to target serious business owners who function as positive role models. IBEC feels that strong role models in the targeted communities will continue as clients, make progressively larger loans, and attract other clients because of thier positive experience in dealing with the organization.

Loan Portfolio Management Policies and Procedures

IBEC pursues a business-like approach to program management and lending. It has established clear quantitative goals and specific expectations for its staff, which recieves back up support from operating and accounting systems which provide portfolio performance data. Clients' business viability is verified through regular assessment visits and focussed technical assistance.

IBEC's portfolio maintenance and development policies include:

- Concentrating on existing, rather than new enterprises;
- Carefully screening, selecting, and assisting a limited number of qualified borrowers;
- Developing a follow-up system to assert growth oriented clients who will become eligible for larger loans.
- Assisting manufacturing enterprises, by helping them adopt more aggressive approaches to sales and marketing.
- Use a cost/profit center approach to planning and monitoring portfolio performance in moving toward financial self-sufficiency.

- IBEC's strategic financial planning has targets for each IBEC office specifying the certain volume of loans and number of clients, it will handle in relationship to staff size.
- Diversify sources of loan funds to meet the financial needs of IBEC's growing portfolio.

Non-Financial Program Service Delivery

Initially, IBEC had a much broader focus which included literacy training and legal services. IBEC has since limited it's non-financial services to business education which is linked directly to its lending program and are an integral part of it's methodology for delivering and monitoring credit.

IBEC does not not offer formal management or technical training courses beyond the introductory orientation, but tries to establish linkages with existing training facilities whenever possible.

Program Monitoring Procedures

IBEC has developed monitoring systems at the organizational, program portfolio, and at the individual client level.

- **Organizational/program monitoring**: IBEC has set organizational objectives for reaching financial self-sufficiency and reports to the board of directors on its progress toward achieving these.

- **Portfolio monitoring system:** One monthly report combines repayment reports and field officer reports on individual clients.
- **Client monitoring:** Field officers are responsible for specific clients and must monitor their clients' repayment. IBEC has access to individual client bank loan account information, and its officers must decide when a client is in arrears.

IBEC's field officers are responsible for their own portfolio of clients, including regular follow-up visits to provide advice, monitor progress, and check on delinquencies. The follow-up contact with clients also offers the opportunity to identify additional business needs and subsequent loans.

The business performance of each enterprise is scheduled to be formally evaluated every three months by the loan officer to determine problem areas (i.e. bookkeeping, cash flow, equipment failure, etc.). Loan officers themselves undergo peer evaluations every six months which supplement ongoing oversight by field managers.

Loan officer performance is stimulated by an incentive scheme in which they receive monthly cash bonuses, based upon their arrears statistics. Shorter term arrears are weighted less heavily than longer ones. Loan officers must keep their weighted repayment rate above 80%, or else they are dismissed. Their remuneration and job security are directly linked to their borrower's repayment performance.

Board of Directors, Composition and Role

IBEC has effectively used its organizing committee and its board of directors to secure broad community acceptance and program participation, mobilize resources, and to serve as advocates for the organization.

IBEC consulted at length with community leaders before launching its new program. These consultations included private sector organizations, large companies such as Mercedes Benz (which has its RSA headquarters in East London), union leaders, ANC leaders, local political leaders in the townships, university and Church leaders. All of those consulted helped to formulate ideas for the creation of IBEC, and many were invited to participate on the board of directors. Some of the positive results of this approach are as follows:

- IBEC quickly became legitimized as an organization because of the broad community participation in its creation.
- IBEC gained political support from the key groups while maintaining its operating independence because IBEC's lending must be seen as completely non-political.
- IBEC received the financial support of major private sector companies. It established a credit relationship with The Perm (also a board member), and created a base for mobilizing grant and loan funds from private and public, regional, national, and international sources.
- IBEC's board is composed primarily of regional leaders, some of whom also have national reputations which could help IBEC's expansion.

- One result of IBEC's community outreach is that it received an initial R5,000 grant plus R12,000 per month from Mercedes Benz of South Africa (MBSA). The Mobil Foundation and other firms have also provided funds.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Loan Fund Terms and Conditions

IBEC's ongoing loan funds originate from a line of credit with The Perm at market interest rates and terms. The Perm's risk is limited to the repayment capability of IBEC, not the individual borrowers. The loans to the clients are on IBEC's books rather than those of The Perm. IBEC is also considering making an application for a line of credit from the Development Bank of South Africa, which will carry a concessionary rate of interest and long payment terms.

Loan Interest Rate Policies

IBEC charges a market interest rate of 21% over an average loan period of 10 months. The organization recently decided that no loan repayment period would exceed 12 months. The rationale was that shorter terms would lead to better repayment behavior and that borrowers could handle the payments over that time period.

Loan Disbursement Procedures

IBEC's disbursement process emphasizes teaching, testing, and evaluation. First, loan officers work with applicants to devise a simple business plan. Next, the loan officer makes a site visit to the current or proposed business premises. This helps IBEC to gauge the seriousness of the borrower and supplies additional information about business viability.

Following the site visit, the loan officer writes a recommendation and submits it to an IBEC loan committee, comprised of upper level IBEC management. The loan committee seldom rejects the positive recommendation of a loan officer.

With the loan committee's consent, the loan applicant is enrolled in a two day course on basic business skills and familiarized with banking principles and procedures. Upon successful completion of training, the loan is disbursed. The size of the loan was determined during the business plan and site visit stages.

The client is responsible for establishing an account with The Perm, and receives help from the loan officer. The client establishes a demand deposit account into which IBEC transfers their loan money, and may also choose to open a savings account at the same time.

Subsequent loans are contingent upon past repayment performance. The loan officer must determine that the business is capable of generating sufficient additional revenue to repay the new and bigger loan.

IBEC firmly believes in lending to individuals. It has concluded that the cost benefit ratio is approximately the same to service groups and individuals. They feel

that group problems are, at their core, problems with individuals. If the program is to be effective, it must reach the individual. However, groups are encouraged to form around business sectors to facilitate exchanges of skills and knowledge, make wholesale purchase agreements or achieve economies of scale by combining work facilities.

Loan Repayment Collection Procedures

IBEC encourages clients to have a direct relationship with The Perm, including making direct payments to the bank on their loan accounts. Aware of the trepidation with which many of its clients view a trip to the bank, IBEC includes elementary bank orientation in its training process leading to disbursement of the loan. The organization does not track savings nor make savings a condition for recieving a loan.

Loan Arrearage and Default Practices

IBEC uses a PC-based loan aging report derived from monthly bank statements and field officer reports. Generally, delinquencies become defaults after 120 days. However, IBEC emphasized that the decision to classify a loan as delinquent rests mainly with the loan officer responsible for the account. A delinquent account could be placed in default before or after the 120 day period.

The 18 month old program has a default rate of 1.81% and IBEC expects to be able to hold that rate to under 2%. An innovative incentive scheme for loan

officers, as well as a participatory approach to lending, gives IBEC a good chance of achieving this goal.

IBEC has adopted an aggressive approach to pursuing bad debt, including seizing assets, referring defaulters to credit agencies, and civil suits. As yet, they have not yet had to apply these these sanctions .

Loan Program Accounting Procedures

IBEC feels that the combination of monthly bank reports and its PC based MIS provides the necessary management information in a timely fashion. Since each client opens a bank account with The Perm, IBEC has access to individual loan repayment performance on a monthly basis from the bank statements. Currently, these monthly updates are supplemented by periodic loan officer visits to clients. In addition to providing technical assistance, these field visits serve as a monitoring tool.

Role of Commercial Banks

The Perm electronically transfers loans into client accounts from IBEC's line of credit. The Perm offers an elementary banking orientation to IBEC clients with the close supervision from the loan officer responsible for the client. Thus far, The Perm's standard month-end account statements have served IBEC's needs. In the future, The Perm will install an on-line monitoring feature to allow IBEC to keep daily track of its loan accounts.

The Perm has estimated that it costs approximately R70 per borrower transaction, including withdrawals, deposits, and other basic banking functions. However, they charge no fees to IBEC or the clients for these services, nor for monthly reports or special reports. Since IBEC has projected that they will have a portfolio of 8,000 borrowers in four years, the bank has been willing to consider the current costs as an investment in the future. In addition, The Perm makes a spread on the interest it charges IBEC on its line of credit.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and Challenges

- IBEC's management identified their first problem as having too wide a programmatic focus. They have now narrowed service delivery to providing credit and business education.
- Another challenge was the need to change the attitude of the Development Bank of South Africa (DBSA) which had a total lack of understanding of the black community. Accessing loan capital from the DBSA is extremely difficult because their bureaucratic processes operate very slowly and because their policies toward black enterprise development are highly prescriptive and uninformed.
- IBEC broke new ground in providing credit and support services to micro enterprises in the black community because there was no

previous experience to build on. IBEC's management and accounting system had to be created from nothing.

- IBEC had to be very careful to ensure that every political and social sector was represented on its board of directors. Politicians have now accepted that the work being done by IBEC is needed in the community.
- It was difficult to find qualified women to serve on the board of directors. The one woman on the board resigned when she moved out of the region. Subsequently, two highly qualified women from the Transvaal Region have been appointed to the board.
- Businesses in the black community suffer from a lack of diversity because blacks are not sufficiently aware of alternative business opportunities. Among blacks, there is a widespread lack of self-confidence about their ability to become successful entrepreneurs because they have traditionally been excluded from performing that role. Because of this lack of confidence, entrepreneurs tend open the same kind of businesses as everybody else, taking comfort in conformity rather than initiating new activities.

Significant Accomplishments

- IBEC's management is proud of their repayment record. Only 1.8% of IBEC's loans have been written off as bad debts and IBEC currently has a default rate which is under 2%.
- IBEC is proud of its holistic approach, providing back-up technical assistance as well as loans, rather than assuming loan money is all that is needed.
- IBEC has good knowledge of the business activities of their clients and insists that they operate according to established business procedures.
- IBEC is particularly proud of the number of jobs it has created through its business loans (1.6 jobs created per loan, with recent data indicating even more promising increases).
- IBEC is proud of the educational value of the certificates it awards to borrowers who repay their loans fully and on time. The certificates are awarded at a large ceremony and are considered a status symbol. Borrowers with three or more of these certificates can use them as a credit reference at formal lending institutions.

Lessons Learned And Recommendations

- Be realistic and narrow your program's focus to what you know how to do well and can accomplish, rather than becoming too broadly focused and losing effectiveness.

- Communicate your organization's goals and objectives and get community acceptance from all groups which could influence the outcome of your program. Balance the composition of your board of directors to reflect a diversity of perspectives within the community.
- Pay your staff market-based salaries corresponding to the value of their experience and education so that they will not be pirated away by other organizations.
- Hire field staff who know their clients, understand their values, and are committed to the idea of using loan capital as a means to achieve economic enablement.
- Focus on staff job performance and client loan repayment capability within a framework of equal gender opportunity. Avoid any gender based hiring and credit targeting bias.
- Offer field agents an occasional opportunity to switch their loan portfolio with that of another field agent. This provides agents with a new perspective and sometimes with new techniques.

D. SMALL ENTERPRISE FOUNDATION (SEF)

1. ORGANIZATIONAL BACKGROUND

The Small Enterprise Foundation (SEF) was established in 1991 as a nonprofit, non-government organization in the rural community of Tzaneen, South Africa. The SEF program was begun by John de Wit based on his experience with the Get Ahead Foundation (GAF) in Pretoria. De Wit is credited with establishing GAF's micro-credit program and organizing successful outreach programs. GAF contracted him to prepare a manual on how to franchise this approach in rural areas.

SEF modified GAF's urban focused approach to its rural environment by organizing borrowers into centers which are located within walking distance (a 1/2 km radius) of the clients' homes. SEF also added a savings mobilization initiative. As a young program, SEF has ambitious growth expectations.

2. PROGRAM SERVICE DELIVERY METHODS

Staff Recruitment/Hiring Criteria and Practices

Although the program is relatively new, SEF has given considerable thought to defining and refining selection criteria for hiring field and supervisory staff. The following is a brief summary of those criteria:

Field Worker Selection Criteria

- Field workers should be 30 years old or older.
- Women are generally preferable but not exclusively.
- Field staff should screen candidates because they can more easily identify people who would be unsuitable.
- Field officer recruits must have strong interpersonal skills and be able to communicate well.
- Field officers should have previous experience with Stokvels or micro-entrepreneurs.
- RSA is a society in transition; potential field officers must be aware of the issues and sensitivities created by this transition.
- Field officers should be literate and numerate enough to be able to write an understandable report.

Selection Criteria for Supervisors

- Supervisors should be old enough to have achieved emotional maturity and sound judgement (35 - 45 years).
- Supervisors should have managerial experience in industry, as a shop steward, and/or as an officer in a civic association. They must have sufficient discipline to make plans and to see that they are done right.
- They should be recognized by the community as someone of good character who is considered trustworthy and reliable.

Client Targeting, Selection Criteria and Screening

SEF has targeted its lending to the rural poor. The initial loan limit of R300 ($99) demonstrates how small these existing businesses are. SEF has limited the size of its loans because it is concerned about the risk of surpassing client capacity to repay.

Loan Application Design and Implementation

SEF uses the group preparation process as a screening device and the equivalent of the loan application process. The group members self-select into groups of five that are responsible for each others payments. During the initial meetings savings are collected toward the minimum amount before lending can start. Field officers carry out at least four training meetings prior to loan consideration. These training sessions cover general orientation to SEF, savings procedures, loan terms, business analysis, and group formation.

Loan Portfolio Management Policies and Procedures

SEF uses borrower groups as a mechanism to create sufficient organizational critical mass for the loan officer to supervise. A center or meeting place is established for six groups of five borrowers, or a total of thirty borrowers per center. They must all come to scheduled meetings at the center with the loan officer. SEF assumes that each field worker can handle four hundred borrowers through the group lending approach, as long as they are grouped together in centers.

SEF plans to expand its portfolio through increased credit lines from concessionary backers such as USAID and from commercial banks such as NedBank. The program has established goals for expansion over the next eight years which include:

- Increasing commercial bank financing from R600,000 to over R8 million;
- Expanding from 6 to 20 field workers;
- Increasing administrative personnel from 2 to 5 people;
- Growing from R235,000 to R12 million in outstanding loans;
- Increasing the number of outstanding loans from 900 to 8,500.

Non-financial Service Delivery

SEF's programs are be restricted to lending and savings. They do not have a non-financial service program.

Board of Directors, Composition and Role

John de Wit has developed a board directors locally, and the program receives support from a USAID grant.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Overview: The Small Enterprise Foundation (SEF) has a non-bureaucratic style reflected in the autonomy given to field staff, direct communication, and its limited

overhead. The organization has set ambitious growth goals for itself, using the group lending concept to both accelerate expansion of its client base and act as an incentive to repayment. SEF has currently (October, 1992) disbursed a total of 955 loans. The average loan size is R411 ($135) with a total portfolio of R392,300 ($130,000).

Loan Fund Terms and Conditions

The program currently has 640 members organized in sub-groups of five members each. SEF targets established businesses (not start-ups) and offers loans of from 300 to 3,000 Rands ($99 to $990). Clients are required to save R5 per fortnight. Each group will save between R75 and R150 before its first loans are issued (maximum of R300 per individual). These savings are deposited in a local bank. SEF charges a market rate of interest (25% flat rate. The effective rate can reach a 53% maximum). They have had no defaults or arrearages.

SEF receives most of its funds on a grant or near-grant basis. It has received a line of credit from NedBank for R60,000 on commercial terms. Recently SEF also concluded an agreement to receive R2 million in loans from the Development Bank of Southern Africa. These funds will cost 7.5% per annum. The program envisions a twelve fold expansion of commercial financing over the next eight years.

Loan Interest Rate Policies

SEF charges a market interest rate of 25% per annum. Terms require bi-weekly payment over the life of the loan, 5 months for first loans and 12 months for

subsequent loans. Because the interest charged is not based upon reducing balances, the effective interest rate can be as high as 53%. Borrowers seem to show little concern about interest rate levels.

Loan Disbursement Procedures

Loan disbursement is programmed through self-select groups of five borrowers. Field officers meet with these groups in a town center in order to reduce the costs and facilitate outreach.

Before groups become eligible for a loan they must establish a savings account with the program and accumulate 5% of the loan amount for which they qualify. This mechanism acts to both supply a loan insurance fund and to serve as a proxy indicating borrower commitment to the scheme.

Once the savings requirement has been met and group cohesion has been established, loans of R300 ($99) are disbursed in cash by the loan officer to group leaders and then to individual beneficiaries. Some borrowers have complained that the R300 first loan is not sufficient even for their relatively small rural businesses. The demand for follow-on loans is huge.

The criteria for the disbursement of a second loan include: perfect repayment records, group consensus on borrower credibility, and an assessment of the borrower's ability to repay a larger loan. So far, few second loans have been disbursed, but the pressure to increase the amount of initial loans and disburse more second loans has grown steadily.

Loan Repayment Collection Procedures

Field officers, recruited from the community and fluent in the spoken language of the area, conduct the large group meetings for disbursal and repayment fortnightly. At these meetings loan repayments and savings are collected by group leaders.

Group leaders have SEF account books, which the loan officers update, recording loan and savings transactions. The group leaders themselves have the responsibility of depositing the money in the local Penn branch. Usually the group designates another member to accompany the group leader to the bank, as a measure of security against extortion or misappropriation of funds.

Field officers send in their repayment reports to the SEF office, where group accounts are updated. The groups have the duty of tracking individual repayment performance and covering for those who do not pay.

Loan Arrearage and Default Practices

SEF has established monitoring systems to immediately follow-up on loan arrears and prevent them from becoming problem cases. SEF has 0% delinquency and none of its borrowers have ever defaulted. SEF's policy on delinquency is that if a group member misses one or two payments, the members in his/her group are responsible for making up the delinquent repayments. Delinquencies which extend beyond two months are classified as defaults.

Loan sizes have not been large enough, nor delinquencies enough of a problem, for SEF to resort to threat of legal action, seizure of assets, or the public

pursuit of defaulters. The less formal culture of SEF's rural environment does not require and would not permit the harsher default practices used in urban programs.

Loan Program Accounting Procedures

SEF has been cost conscious from its creation. To decrease overhead cost, SEF has no office and operates from the home of its director. The program uses a minimum of office supplies and its management and administrative staff is limited to the director and a part-time assistant. Field operations are similarly streamlined.

SEF has a PC-based MIS maintained by the director. The MIS tracks data on the number of clients, group repayment rates, savings performance, the number and amount of loans outstanding, and program budget information. These figures are used for monitoring and forecasting of key program ratios such as cost per Rand lent and loan officer carrying capacity.

Role of Commercial Banks

The local Perm branch offers basic branch banking services to SEF and its clients. SEF keeps its disbursement accounts with The Perm and its operational account at Standard Bank. Groups transac business through their own accounts at their bank.

SEF has established an institutional relationship with NedBank and expects the bank to provide more financing on the basis of SEF's repayment record under its current line of credit.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and Challenges

- There were no words for "sub-committee" or "workshop" in the local tribal language. Therefore, both the concept and the language has to be explained when SEF establishes its group centers.
- Clients become very attached to their group centers and are often reluctant to form centers in a different location when center membership becomes too large to be manageable.
- SEF is concerned about offering entrepreneurs loans which are either too large or too small to be used effectively in their businesses. SEF is currently thinking through ways to design different loan packages for specific SME sectors so that loan amounts will be responsive to actual needs.
- The current system of tracking member's repayments through their bank deposits does not provide information quickly enough so that field workers can focus attention on individuals experiencing problems.
- Some borrowers need to replace their resistance mentality with one geared to development objectives. This is difficult because of the protracted and intensifying nature of the struggle against apartheid.
- The black population has been systematically denied access to management positions, which resulted in a scarcity of blacks with the

required experience and expertise to fill SEF middle management jobs. There are very few black women applicants.

- De Wit commented that white people in the Republic of South Africa have been isolated from the black experience and do not understand the culture of that community. This knowledge gap can only to be closed through education, with considerable reliance on SEF staff members from the black community.
- De Wit is committed to increasing the household income of SEF's clients. He feels that business growth will lead to employment creation and increased disposable income.
- Poor rural clients are intimidated by banks and are not aware of their "rights" as depositors. They need to be educated about how to fill in a deposit slip, how to answer questions bank tellers may ask, and which line to stand in. This fear of banks must be overcome because it acts as a disincentive to regular savings.

Significant Accomplishments

- SEF is pleased that their clients have been able to understand the program's administrative system and their responsibilities as borrowers.
- Indications are that SEF's initial estimate of demand for credit in rural areas has been accurate and will support further growth.

- SEF has not noticed specific weaknesses in its administrative procedures or financial controls, which has prompted an attitude of cautious optimism.

Lessons Learned and Recommendations

- Early indications are that the Get Ahead Foundation's urban focused approach can be replicated successfully in rural areas.
- The key to creating a sustainable program is to select the right clients. Peer pressure does not always work. When people refuse to pay, it is very difficult to force them to repay in the absence of collateral.
- Simplicity in explaining repayment procedures is more important than the loan interest rate charged.
- Provide loans to established businesses rather than start-ups because they have proven their commitment and are less fragile.
- Start with the philosophy that money is tight and that all staff members must be conscious of the need for cost reduction and recovery.
- Be sure that loan deposits are witnessed by group representatives and that multiple signatures are required for withdrawing deposited funds. Such checks and balances arrangements reduce client suspicions that their funds are subject to misuse.

II. KENYA

A. KENYA RURAL ENTERPRISE PROGRAMME (K-REP)

1. ORGANIZATIONAL BACKGROUND

The Kenya Rural Enterprise Programme (K-REP) was established in 1984 as a five year intermediary organization to provide training, technical assistance and financial management systems to local NGOs to improve their capability to design, manage and implement small scale enterprise development programs.

The assumption was that after five years, these NGOs would improve sufficiently so that USAID/Kenya could channel funds to them directly. K-REP's function as an intermediary organization would then no longer be necessary.

In 1987, USAID/Kenya provided loan funds to K-REP which began to increasingly focus on minimalist credit. K-REP's objective was to get 20 NGOs to abandon their social welfare mentality and adopt a business-like approach to achieving financial self-sufficiency. K-REP also stressed that these NGOs must end their long term dependency on donors. Donors should be seen as providing temporary capital to help NGOs build a sufficient financial base to become independent.

K-REP's small scale enterprise minimalist credit operation made 5,058 loans to SMEs last year, with a loan repayment rate of 95 percent. K-REP estimates that it has been able to create 1,011 new jobs and improve the standard of living of the estimated 5,000 micro and small scale entrepreneurs.

2. PROGRAM SERVICE DELIVERY METHODS

Overview: During its first phase, K-REP acted as an intermediary organization channeling USAID funds to NGOs doing informal sector lending. K-REP also functioned as an umbrella organization which provided managerial technical assistance to these NGOs to improve their capability to develop and manage credit programs.

During the second phase, K-REP reduced the number of NGOs receiving technical assistance from twenty to four, all of which were using a group approach to informal sector lending.

K-REP also began its own informal sector lending program, called the Juhudi Credit Scheme which lent money through a group mechanism. K-REP has developed its Juhudi Credit Scheme by applying lessons learned from both Kenyan and external loan program experiences.

Recruitment/Hiring Criteria and Practices

K-REP has an excellent Kenyan management team which has developed effective approaches for recruiting and training its staff. K-REP seeks personnel who have a business rather than a welfare mentality.

K-REP recruits and hires staff members who see themselves as selling a valuable service to business people, rather than giving something to a needy person. They recruit and hire people who understand that small and microenterprises must be able to earn an adequate profit in order to survive.

K-REP stresses that they hire personnel who understand the value of developing staff cohesion and unity which is strengthened by team meetings and social gatherings.

Client Targeting/Selection and Screening

K-REP targets new or existing informal sector businesses which don't have access to commercial credit and can respond effectively to its Juhudi Credit Scheme. It targets individually owned businesses which can profitably use a first loan of up to Ksh. 10,000 (about US $330), followed by incrementally increased loans. These businesses must be willing to participate in a group which processes loans and repayments, mobilizes savings and jointly secures the loans of group members.

K-REP also targets clients through its Area Credit Office (ACO) which is treated as a separate profit center and operates as a virtually independent entity. An ACO serves a radius of not more than 5 kilometers and is located in an area with informal sector enterprises large enough to generate 1,800 quality clients over the first year.

ACO credit officers promote the formation of self-selected membership groups which follow the basic criteria of the K-REP program. Group members are responsible for verifying:

- Whether the person requesting a loan actually has a business;
- Whether the amount of the loan is reasonable;
- Whether the potential borrower is able to repay the loan;

- Whether potential borrower will save as required; and,
- Whether he/she will cover the debt of members who default.

The credit officer trains group members to understand and perform these screening, monitoring and group loan guarantee responsibilities. K-REP stresses the need to carefully prepare these groups by improving their ability to appraise the size of the loan needed and the borrower's repayment capability.

Loan Application Design and Implementation

The loan application process is handled by five member groups called Watanos which are comprised of business people who know each other. Six Watanos are grouped together to form a KIWA with 30 members living in the same area. Watano members are required to save 50 Ksh each for eight weeks before the first loans can be received.

During this initial period, training and orientation is given to the KIWAs by K-REP's credit officers at the weekly meetings during which savings are collected. These sessions cover group formation, responsibilities, program procedures and related matters. It is also during this period that the group members define and appraise each others loans. The Watano group members become each others guarantors.

K-REP disperses loans to three of the five Watano group members after the first eight weeks, if savings and group training goals have been achieved. The disbursement is done through the KIWA at their weekly meeting. Following a second

period of 4 to 8 weeks during which savings, loan repayment, and meeting attendance are monitored, the last two members of each Watano in the KIWA are eligible for loan disbursement.

K-REP's experience is that most members requested and received the maximum first loan amount of Ksh.10,000. which was apparently approved by their group members without adequate loan appraisal. As a result, K-REP's credit officer is now more involved in the approval process of the first loan. The second loan, which may be larger, involves more detailed appraisal and approval process which requires more loan officer participation.

Loan Portfolio Management Procedures

K-REP is using the ACO branch concept as a management and planning tool to define the number and volume of loans necessary to break-even which serves as a yardstick for determining the entire organization's costs and income.

By setting an initial low loan ceiling on each group member, K-REP minimizes its risk with new borrowers. After clients establish a good track record, they become eligible for larger loans. The amount of attention to loan appraisal also increases as the amounts increase. This incremental treatment is also applied at the level of the group. In order for the group to be eligible it must carry out its responsibilities.

K-REP has established a loan insurance fund to which all borrowers contribute one annual payment of 0-5% of the principal loan amount. This covers extraordinary losses due to death or disability.

K-REP also has a three tier guarantee system to cover loan losses from savings. A loss is covered first from savings of the defaulting member, then equally from other Watano members, then equally from other KIWA members savings. K-REP also maintains a reserve account with 1% of payments to cover bad debts.

K-REP requires credit officers do timely updating of the group's pass books which record all transactions, which are also reported on the management information system. K-REP has helped the NGOa with whom they work develop MIS systems which accurately monitor the quantity and quality of their loan portfolios. Yearly bonuses are tied to portfolio performance levels.

Non-Financial Program Service Delivery

K-REP's Juhudi Credit Scheme has concentrated on developing a successful financial systems approach to informal sector lending. Therefore, they are trying to eliminate or minimize nonfinancial assistance program components.

K-REP's Juhdi program does not offer broad based training or technical assistance to informal sector borrowers. They are trying to determine how much training in group formation, financial loan assessment and evaluation of the potential borrower's character the Watano and KIWA need to function effectively. It will be

interesting to observe the extent to which Watano and/or KIWA groups become involved in focusing business assistance among their members.

Program Monitoring Procedures

K-REP has a well developed monitoring system which contains detailed baseline information from their clients. Information collection is repeated when a second loan is requested. The portfolio is monitored in monthly reports covering the status of the portfolio and an analysis of performance.

K-REP does periodic impact studies, as well as comparative analysis with the portfolios of the other NGOs doing similar lending of funds channeled through K-REP. This provides a rich opportunity to learn rapidly from K-REP and the experiences of other organizations. K-REP documents and disseminates portfolio performance information to other credit providing NGOs within its network as part of its role as an intermediary and technical support program.

Board of Directors Composition and Role

K-REP began as a program intermediary of USAID. Over time, it has grown into a separate institution striving to reach financial self-sufficiency and independence.

K-REP has a 10 member board which includes representatives from the development, academic, political, and finance communities. Because of the financial and institutional objectives of K-REP, it will need Board involvement by leaders who

can help guide the organization toward a market oriented approach. In addition, the Board can help K-REP forge strong links with the banking community.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Overview: At the core of K-REP is a well developed team management philosophy, which defines the organization as a long term business rather than a short term program activity.

K-REP places heavy emphasis on gathering client information, tracking performance closely, and using this data to continuously assess the program's soundness. K-REP monitors and uses data on portfolio at risk, quantitative and qualitative repayment calculations, credit officer performance, branch level profitability, and a host of other indicators.

Loan Fund Terms and Conditions

Most of the funds that K-REP has 'ent to other NGOs have been on concessionary terms, with interest rates of 5% and terms of five years. For its own lending through the Juhudi program, the organization has been successful in raising donor funds and securing low cost financing from international development organizations. K-REP is providing a 70/30 mix of loans and grants.

Loan Interest Rate Policies

K-REP charges an interest rate of 27% p.a. on reducing balances. They offer repayment terms of 13, 17, 26, 39, and 52 weeks. The interest rate reflects the attitude that the organization's credit programs must move toward sustainability. The spread on money lent is a component of their revenue stream. K-REP also charges a loan origination fee of Ksh 100 and fees for technical assistance and other client services.

Loan Disbursement Procedures

In K-REP's Juhudi group lending scheme, self-selected participants are formed into groups of five called Watanos, clustered in groups of 30 people called KIWAs. Local credit officers generally have responsibility for 10 KIWAs.

Loans are disbursed to three members of each Watano, following eight weeks of saving Ksh 50 per week per member, registration, program orientation, and appraisal of economic activities. Both the credit officers and group members do loan appraisals, assessing the applicant's integrity and assuring members that the enterprise for which the loan was requested does exist.

Other group members receive their loans within eight weeks of the first disbursal. Check disbursements go directly to the borrowers. Average initial loan size is Ksh 10,000. Recent modifications to the program have yielded some beneficial differentiation among clients in terms of loan size. This has meant that loan amounts more closely match the actual business needs of the enterprise.

K-REP has considered developing specific credit products for various sub-sectors of its market, defined by the type, size and sophistication of the businesses. Different products would be offered to the appropriate clients. More financially viable clients could subsidize higher risk clients, helping K-REP achieve self-sustainability and still meet its social goals. Evaluative criteria for those two elements of the portfolio should be different to reflect relative risk and difficulty.

Loan Repayment Collection Procedures

Watano and KIWA group leaders have the responsibility of collecting the loan repayments and savings contributions at each week's meetings. They keep the records and pass on the money and receipts for money collected to the local Juhudi credit officers.

K-REP has tried to place a great deal of autonomy in the hands of credit officers who have a clear set of procedures and follow up actions. Timely and consistent updating of the Pass Book, in which all individual and group transactions are first recorded, is the key element in monitoring client performance. Attendance at group meetings and occasional visits to individual places of business help to foster a good rapport and supplements other monitoring.

Loan Arrearage and Default Practices

Members who are four consecutive or cumulative installments in arrears are considered to have defaulted. Loans are considered to be in arrears when borrowers

are behind for up to three weekly installments. Loan recall occurs in instances where KIWA members, who have failed to collect amounts in default in full, are required to repay the total outstanding amount from their group savings.

Using the on-time repayment ratio, the average loan repayment rate is 99%, with 25 borrowers out of 1,320 in arrears or having defaulted. In addition, 5% of the portfolio is considered at risk due to the fact that the borrowers are either late in their installments or in default.

In cases of default, the defaulting group member, who is considered the primary guarantor, forfeits their portion of savings plus interest earned to the extent of the amount in default. When that is insufficient, the other Watano members, acting as secondary guarantors, forfeit their savings in equal proportion to cover the remaining unpaid balance. When some default amount remains, KIWA members act as final guarantors, forfeiting their savings in equal proportion to cover the remaining balances.

Loan Program Accounting Procedures

K-REP's PC based system provides standard reports showing individual, group, and branch office performance in terms of loan repayment and savings record. These reports contain quantitative and qualitative loan repayment rates, delinquency rates, recovery rates, loan eligibility ratings, portfolio at risk calculations, and other analytical percentages and ratios. The baseline and comparative data come mainly

from the loan applications, intake forms, banking receipts, and credit officer transaction registers.

In addition to the standard monthly reports, K-REP produces periodic studies aimed primarily at assessing the program's impact. Currently the organization is in the second year of a three year impact study, using a control group of its Juhudi borrowers.

In budgeting for new branches, K-REP builds in a 78% repayment rate (far below empirical history) to establish a lower level performance threshold. This gives the program room for experimentation in a new and largely untested market. The first Juhudi branch is 1.5 years ahead of its projected self-sufficiency targets.

Role of Commercial Banks

K-REP has made few linkages with commercial banks, other than to use them for normal operational services at both headquarters and branches. K-REP has seen little interest on the part of the formal financial sector in Kenya to assist SME programs. K-REP is considering making its operations more bank-like, without diminishing its development orientation of assisting poor people without access to credit.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and/or Challenges

The Umbreila Organization

The first section of this discussion of problems, constraints and/or challenges experienced by K-REP, focuses on its function as an umbrella organization providing small scale enterprise technical assistance and training to local NGOs.

- The first challenge K-REP faced as an umbrella organization was to decide whether NGO social welfare organizations can adopt an institutional strategy of financial sustainability and become cost effective SME development organizations.

  This is particularly difficult because the mandate, experience and staff attitudes of these NGOs are those of social workers rather than field officers assessing and collecting loans. People with a social worker mentality experience discomfort asking poor people to repay loans and are more comfortable giving them what they request.

- K-REP also experienced problems of managerial over-extension during its early stages because a staff of seven people (half of whom were administrative personnel were attempting to upgrade the program capacity of over 20 NGOs. This was an unrealistic performance expectation.

- Many of the NGOs to whom K-REP was providing organizational development services had many different program priorities and were not focused exclusively or even primarily on SMEs. In addition, these NGOs tended to have a strong charismatic leader who was reluctant to delegate functions which hindered staff development.

The NGOs were also constrained because they paid low salaries which made it difficult to attract and keep good staff who receive offers of higher salaries and better benefits elsewhere. There was also some friction caused because K-REP pays market level salaries and NGO staff members with comparable jobs were making much less.

- The NGOs being assisted by K-REP are autonomous organizations which were reportedly accountable to the community. But in practice this meant accountability to a local chief, GOK representative(s), church officials or in one case a Peace Corps volunteer who provided the required vision. There was generally an absence of a representative Board of Directors with decision-making capability. K-REP had a responsive management style and could not set performance standards.
- K-REP was trying to avoid creating a relationship of either managerial or financial dependency. However, when they designed a financial management bookkeeping system, an MIS system and/or a monitoring/ evaluation system they were given ownership of those functions by default. When K-REP attempted to transfer responsibility for those functions to the NGOs by withdrawing, the NGOs claimed that the poor would suffer as a result or that their staff would be over-burdened and perform poorly.
- The NGOs saw the MIS systems which K-REP designed for them as a means of producing reports for external donors whose expectations they

had traditionally accepted in a passive manner. They did not see the MIS system as an internal tool for making better informed management decisions to shape their own programs. Their relationship with donors was seen as long-term and passive, rather than as an infusion of capital to broaden their financial base so they could become independent.

- Another constraint to NGO organizational development is that they have a program/project mentality rather than establishing an institutional strategy of long term financial sustainability. Projects and programs have implementation time lines which begin and end. These NGOs see their staff as fluctuating with donor initiated and supported projects/programs rather than having permanent employment conditional upon performance and income-generating capability.

The Minimalist Credit Program

- K-REP needs to expand its micro/small enterprise lending program, but has to allocate a significant amount of staff time and resources to its NGO umbrella function. This creates a risk of management over-extension which would lower service delivery performance to both program activities. K-REP is now considering dropping its NGO umbrella function or somehow spinning it off in order to specialize exclusively in credit services. The issue is how to do this without harming the organizational development process of these NGOs.

- K-REP's staff is working long hours (10 hour average work day, plus weekends). Their workload doesn't allow time to discuss "the program's success" with a steady stream of visitors who want to analyze or replicate K-REP's approach and systems. Some means has to be found either to minimize these interruptions or have visitors pay for the programmatic information and advice they receive. K-REP now produces and disseminates explanatory information on its program, but this can have the effect of attracting additional visitors.
- K-REP's efforts to expand its operations comes at a time when the Kenyan economy is slowing down and a political transition away from the traditional one party system is underway. The money supply is short, the prices of some basic food commodities recently rose by 50%, the drought has decreased the maize supply and inflation is rising. The incidence of robbery, arson and murder are increasing and it is unsafe to travel in some areas targeted for program expansion. Poor people are thinking about survival rather than the long term benefits of savings and business growth. This is a difficult ambience in which to implement an expansion policy.
- Another troublesome aspect of K-REP's growth strategy is that more staff will be hired and the workload will increase, leaving less time "to think and debate" organizational development issues. There is a concern that the time demands of an expanded workload may cause the staff to

function in a more mechanical and less creative and innovative manner. This is a significant concern because K-REP has a highly participatory management style which stresses the need for high levels of staff discussion and debate within its team dynamic.

- K-REP now has its first black Kenyan Managing Director who has replaced the organization's two previous white managers. There is perception that white managers are better able to get money from donors. K-REP now feels that it must intensify its efforts to educate donors so they will know how well the organization is functioning and support its growth objectives without attempting to micro-manage the program.
- K-REP is also concerned that it not be regarded solely as a credit organization because it sees that program function as part of its overall empowerment and policy/regulatory advocacy objectives. K-REP does not see this as a question of whether or not to implement a broader development vision, but rather how, when and what resources should be devoted to development education and increasing political legitimation.
- K-REP sees its long term financial sustainability as somewhat "fragile and sensitive" and is examining ways to diversify its income streams and establish a financial cushion.

- K-REP is not currently registered as a bank capable of taking deposits. The membership of community organizations directly or indirectly associated with K-REP's programs have generated a significant amount of savings capital. K-REP feels that the savings of these depositors could be better utilized by a socially responsible banking operation capable of effectively channeling those funds into community development.
- Since banks have multiple product/service packages, becoming a bank would diversify K-REP's income sources rather than getting growth funds exclusively from loan interest revenue. K-REP is considering what effect becoming a deposit taking bank would have on its overall development goals.

Accomplishments Management Feels Good About

- K-REP is proud of its success in transforming a project which was intended by USAID/Kenya to end after five years to a significant Kenyan controlled microenterprise development organization. There is now very little small scale enterprise operations of either the GOK, NGOs and/or the private sector in Kenya which does not consult K-REP.
- K-REP has been able to document its learning experiences and disseminate them to other NGOs to avoid a situation in which valuable

time and scarce resources are wasted in an unnecessary trial and error process.

- K-REP takes pride in its trackrecord of having made over 10,000 loans in the six year period since 1986, 2,100 of which were made in the last 20 month period. The repayment rate is over 95% and there is a strict policy of monitoring any client who is in arrears on his/her loan before the problems they are experiencing endanger overall repayment.
- K-REP's training and technical assistance have had a positive impact of the NGOs within their umbrella organization. The average level of loan recovery has gone from 30% to 80% which is unprecedented and exceeded the expectations of these NGOs. However, K-REP does not consider a 20% default rate to be adequate and is working with these NGOs to get close to 100% repayment.
- K-REP has succeeded changing both the attitudes and behavior these NGOs from highly subsidized poverty lending which didn't believe in interest charges nor knowing the cost of capital to a more commercial systematized approach.
- Informal surveys of the members of these NGOs has shown that K-REP has "made a difference" in both their standard of living and quality of life. Their is no hard impact data at the present time, but interviews with clients done by K-REP representatives have been positive.

- Most African SME programs have been designed and run by expatriates who were considered essential to achieving a cost-effective sustainable organization. K-REP is now 100% operated by Kenyans who have full responsibility for the design and operation of the program.
- K-REP takes pride in having developed a staff which functions as a highly disciplined and successful team which functions in an open system in which criticism of management is encouraged. This is in contrast to the traditional "big man" role in African organization in which the director makes all decisions, delegates very little authority and does not encourage participatory problem-solving.

Lessons Learned and Recommendations

- Don't reinvent the wheel. Learn everything you can from the experience of others in similar circumstances and make the necessary adaptations to fit local conditions. Don't play God (trusting only in your own intuition) and believe you must start from scratch.
- Formulate a working definition of your targeted micro/small enterprise group and clearly define your programmatic objectives. Focus on providing credit and getting repaid in a cost effective manner. Keep fine tuning your service delivery methodology until you think you have got it right.

- Leave room for small scale pilot experimentation with new tactics and approaches. Draw lessons from your experience and test creative ways to apply them in difficult small scale enterprise environments.
- Think through and clearly articulate your mechanism for providing credit. The three most important factors in this systematic approach to program management are numbers, numbers and numbers. These programs lend small amounts of money (predetermined loan size) which means that volume is the key to viability. Managing large scale operations is difficult and inadequate management information systems quickly become overwhelmed and dysfunctional.
- Our experience has been that NGOs with a social welfare orientation are not well suited to run a cost-effective small scale enterprise loan program. Converting NGOs with a social welfare value system to the need to charge adequate interest and enforce demanding repayment procedures is generally not recommended. NGOs providing SME credit services should specialize in that function rather than offering it as an adjunct to programs "giving" people goods and services.
- Invest in staff development to build commitment and a shared vision of organizational goals and objectives. A sense of commitment can be induced and reinforced through participatory management. Delegate high levels of responsibility along with high performance expectations.

- Provide staff training and financial incentives. Provide clear feedback when the staff is doing well and point out areas which need improvement. Have frequent informal social gatherings to reinforce the staff's sense of belonging and playing a valuable part in the whole scheme.
- Staff training should be done holistically, stressing the "why" of the procedures and techniques they are learning rather than focusing exclusively on that "what" (specific task oriented skills). The temptation to give people a check list of what to do when without an understanding of how it fits into overall organizational goals and objectives should be overcome.
- Don't advertise yourself and avoid self-promotional "hype" of any kind. Let people realize what you do through consistent example. Don't tell them how good you are.
- Develop your financial systems and management procedures in coordination with program design and implementation activities so they are integrated and responsive.

B. KENYA INDUSTRIAL ESTATES INFORMAL SECTOR LOAN PROGRAMME

1. ORGANIZATIONAL BACKGROUND

The Kenya Industrial Estates Informal Sector Program (KIE/ISP) was established in 1988 to provide capital to established micro/small scale entrepreneurs primarily in rural areas. These manufacturing, service and/or retail sales enterprises have an average of two employees.

The KIE/ISP program provides loans of up to Ksh 50,000 (1 US = 32 Ksh) for first time borrowers and Ksh 100,000 for second time borrowers. The interest rate is 18% per annum on the declining balance (will be raised to 22% in July of 1992).

Training is provided in business plan preparation, marketing, and costing analyses. Loan repayment is monitored by 35 Field Officers who operate in 27 districts of Kenya.

2. PROGRAM SERVICE DELIVERY METHODS

Overview: KIE-ISP lends directly to individual businesses, rather than using the group lending approach. It functions within a government entity or parastatal, as opposed to being an NGO or non-profit corporation.

GTZ (a German development funding agency) furnished the advisory staff to establish and implement the new program, as well as funding. GTZ has provided high

quality top advisors for the early years of program setup, testing, expansion, and transition to local management on a five year timetable.

ISP has worked to develop a separate organizational culture and dynamic, isolating itself as much as possible from its parent paratatal. ISP reports that they have succeeded in developing a strategic thinking capacity within its staff, so that there is unity of vision as to their direction and mission.

The ISP started in 1988 and now operates in 27 locations through 22 offices spread around Kenya which are part of the KIE structure. Operating through a nationwide structure of existing offices, provides a broadly focused program experience and perspective most other organizations lack.

Recruitment/Hiring Criteria and Practice

ISP's management has focused on recruiting quality entry level personnel, providing comprehensive field and in-house management training and promoting staff from within to fill middle and eventually upper level management positions.

ISP has invested in recruitment, selection, and training of field staff. The result has been what ISP considers quality performance from this field staff and very low turnover. To achieve this result, ISP offers competitive salaries, an opportunity to work with a committed staff in a growing internationally funded organization, and extensive in-house training.

Secondly, ISP has tried to target types of individuals that have a high chance of job success. For example, they don't recruit over qualified people who won't find the job challenging or fulfilling.

The recruits pass through a series of steps before final selection, with weaker candidates weeded out along the way. The process starts with a three hour written exam, then personal interviews. Remaining recruits participate in a one day assessment exercise during which they role play and are tested on the various skills and capabilities needed to do the job well. Recruits who are chosen, achieve excellent performance levels.

ISP provides detailed job descriptions for all positions and have established performance criteria. They are trying to move to performance based contracts with all personnel. In an organization with its staff spread around the country in 21 offices, systems must be well defined, job descriptions clear, and monitoring must be effective.

Client Targeting/Selection and Screening

ISP has targeted a segment of the informal sector which it considers particularly appropriate for their program services, approach and methodology. They are targeting existing, rather than start-up, micro enterprises in manufacturing, service, and retail sales that have considerable growth capacity in employment, assets and value added.

ISP concentrates on the immediate areas surrounding their 21 regional offices. It provides pre-credit and management training to micro enterprises which employ up to 5 employees, require initial loans up to ISP's limit of Ksh. 50,000 and don't have access to loans from commercial credit institutions.

ISP estimates that Kenya has over 350,000 microenterprises which fit its target criteria. However, ISP can assist only 1000 or so each year. Therefore, ISP is can select only enterpreneurs with good growth capability as their target group. They expect the performance of these target microenterprises to provide a demonstration effect to attract other clients with similarly high growth capability.

ISP has developed an approach which incorporates business training and management assistance during the selection/screening process rather than afterwards. A series of requirements or hurdles are established prior to loan approval, so that only serious candidates with real credit needs, business management capability and determination are able to qualify for loans.

These screening requirements or hurdles include:

- The first step is buying a Sales And Raw Materials Form for Ksh. 50 which must be filled out for one month;
- This is followed by a site visit from a field officer who verifies that the business is operating and gathers some performance information;
- The candidate is then allowed to register for the Client Orientation Program (COP), if the ISP field officer reports that

he/she has successfully completed first two steps. The COP is a training and orientation program with two day sessions per week attended by about 15 candidates over a four or five week period.

During the COP, all candidates develop their own business plan which defines their growth capacity and the size of loan required. The field officer analyzes the business plans and if satisfied, that information is used for a formal loan application which is then submitted to the loan committee. The COP covers a series of basic management subjects, planning skills and exercises which emphasize marketing and costing.

- During the approval period, the loan candidate must get two loan guarantors and a favorable reference from the local chief or official. He/she must also prepare chattel mortgages on movable property owned by the loan applicant or their guarantors which ISP uses to secure the loan.

Loan Application Design And Implementation

The information to be contained in the loan application, including specific credit needs, is all provided during the COP as explained in the previous section.

Loan Portfolio Management

ISP has a commitment from GTZ and other funders for sufficient future financial support so that funding constraints are not a factor in program development.

ISP has a well defined target population and can plan the number of COPs they will carry out annually in each section of the country. The regional loan officers must get head office approval for each COP before starting a new group. If the regional office has an arrears problem, they may be required to overcome that problem before being allowed to start a new COP.

ISP has a well developed management information system which is an important tool in portfolio management. Regional offices report monthly and quarterly to headquarters which regularly follows up on problem borrowers. In those cases where arrears are not cleared up, ISP contracts collection services to take further steps, including taking court action and seizure of mortgaged property.

Non-Financial Program Service Delivery

ISP's program concentrates on providing loans. Business assistance is provided during the screening/preparation process through the COP during which a business plan is formulated.

ISP has developed a set of parameters for analyzing sub-sectors commonly encountered in their manufacturing, service, or retail sector clients. This information helps guide the field officer when he/she is assisting with business plan preparation or providing other nonfinancial assistance to clients.

Program Monitoring Procedures

ISP reports that for over 18 months they have had an excellent monitoring systems and MIS in place. This includes monthly information, including aging of loans, from all field stations which allows then to monitor by field officer and by region.

By developing business plans prior to the loan approval, they have baseline data on all clients. This is followed up with semi-annual performance reports on each borrower and yearly client impact studies. ISP's information on portfolio performance is more than adequately to meet their reporting and learning needs.

Board Composition and Role

The ISP is the only institution the CEC field team visited which does not have a Board of Directors of its own. This is because ISP is part of the Kenya Industrial Estates (KIE) which is under the authority of the GOK Ministry of Finance and the Ministry of Industry.

As a result, ISP lacks the type of non-political links with the community at the Board level. There is also a lack of control over hiring and firing and restrictions on salary levels. ISP has been working to increase its independence under the mandate of the Parastatal Reform Movement in Kenya.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Overview: KIE/ISP disburses loans on the basis of the applicant's ability to meet the requirements necessary to overcome a series of "hurdles" which function as a screening mechanism. Applicants are required to pay Ksh 50 for the initial evaluation form, which is an indication that they are serious.

The "hurdle clearing" process consists of a series of tests, evaluations, and assessments of the potential borrower's trainability in basic financial management skills before loans are approved and disbursed. Obtaining character references from local chiefs is another "hurdle" to be cleared. Loans are secured by attaching moveable assets, using a chattel mortgage of up to 130%.

As part of an on-going process of administrative streamlining, the KIE/ISP program has plans to attain a "turn-around time" of 90 days from loan approval to disbursement. Current average performance is 180 days, with some documented cases of over one year.

KIE/ISP has mainframe-based monitoring systems which can produce ad hoc and scheduled program performance reports at all levels. Because KIE/ISP stresses data collection, evaluation and documentation, its field officers realize the importance of making accurate, timely reports to headquarters. The organization also conducts yearly client impact studies.

Loan Fund Terms and Conditions

KIE/ISP receives its loan funds on soft loan and grant terms from GTZ and the Belgian aid organization. Cost of funds is very low, and availability appears to be adequate. KIE/ISP recently signed a funding commitment for an additional Ksh 50 million (approximately $1.7 million) from GTZ, and has an agreement with the Belgians for a further Ksh50 million.

They insist that the program be perceived as a bank, so that repayment commitments from its borrowers will be taken seriously. Their policy decisions on types of interest rates, loan sizes, recovery rates, and other variables reflects this commercial orientation. KIE/ISP also analyzes businesses requesting loans on the basis of return on capital, market feasibility and longer term sustainability.

Loan Interest Rate Policies

Currently, KIE/ISP charges 18% p.a. on declining balances and will increase the rate to 22% p.a. in July, 1992. Loan maturities are between 2 and 3 years, including a one month grace period immediately following disbursement. The average loan amount is Ksh 24,000, with the maximum for first time borrowers at Ksh 50,000 and at Ksh 100,000 for second time borrowers.

At present commercial banks in Kenya charge 20% or more for some commercial loans. Barclay's and Kenya Commercial Bank charge 18% with a 100% guarantee in their small businesses loans.

KIE/ISP has determined that on average loans at the 18% interest rate yield a 12% to 13% real increase on capital employed within the businesses to which they lend. In addition, they have found that a 4% increase in the interest rate will mean a Ksh 50 payment increase per loan per month. At their current portfolio size, that would yield a significant increase of Ksh 1 million in revenue, without creating an undue burden upon their clients.

Similar to other small enterprise credit programs, KIE/ISP has found their market to be very interest rate inelastic, although they are not sure of the outer limits of tolerance to interest rate increases. The program lends mainly to small manufacturing operations, and retail businesses in the more remote or lower income areas of Kenya.

However, to generate a greater revenue mix, and hopefully higher revenues, KIE/ISP is considering offering other credit products. For example, a short term working capital facility, which would carry a higher interest rate and a fee.

Loan Disbursement Procedures

The entire disbursement process, from the time the applicant first enters the field office to the time the loan is approved, requires approximately 3 to 4 months on average. Delays at this stage usually occur in the securing of character references from chiefs and the signatures of two guarantors. Loans are made only to individually owned businesses operating from a fixed location.

Field officers must take care in confirming that the assets offered in the chattel mortgage actually exist and belong to the person applying for the loan. Loan disbursal is made to suppliers, not directly to the entrepreneurs. No more than Ksh 2,500 is ever disbursed to the small business entrepreneurs themselves. KIE/ISP is trying to reduce the time between loan approval and disbursement to 90 days from the current average of 180.

Loan Repayment Collection Procedures

KIE/ISP clients do not open bank accounts with local banks to facilitate disbursement, savings, or repayment. Savings are not required but are passively encouraged. On a monthly basis, loan officers make collections in cash from clients who walk into local regional offices or by the loan officers making on site visits to the businesses.

Clients receive receipts, and loan officers tabulate repayment and submit reports and supporting documentation to the headquarters. Payments are made to KIE-ISP accounts at headquarters in Nairobi. Internal client accounts are updated and shadow records kept.

Loan Arrearage and Default Practices

KIE-ISP treats arrearages and default very seriously, and makes it very clear that formal legal action will be taken against the worst offenders.

KIE/ISP has four categories of borrowers:

"A" Clients have a clean repayment record and are up to date on all of their principle and interest payments.

"B" Clients have one incident of arrears lasting for one month.

"C" Clients have at least three months of accumulating arrears (which may mean three separate months of non-payment or one incident of repayment outstanding for 3 months).

"D" Clients have at least six months of accumulated or single arrears.

Category "A" borrowers make up 45% of their portfolio, and 83% of the Ksh due as of the end of August had been collected. KIE-ISP expects its repayment figures to improve when the bad debts inherited from a previous program ages or is collected. KIE/ISP is confident that the program's improved screening and monitoring systems will yield good repayment records.

Legal action is instituted at the C level. This includes dunning notices, threats of repossession, and warnings of suits. KIE-ISP will make public display of repossession to punish defaulting clients and send a clear message to other clients or prospective applicants. KIE-ISP itself performs the repossessions, and hires professionals to do the legal work related to seizing assets, serving notices, and taking people to court

Loan Program Accounting Procedures

KIE/ISP has had its mainframe based monitoring system in place for about a year and a half. It can access all of the key data necessary to monitor and manage the program. These indicators include: average loan size, aging reports, regional data, loan officer data, and financial ratios (i.e. quality and recovery rates, and portfolios).

Data collection and monitoring functions are done almost exclusively at the main office in Nairobi. Field keep paper records of transactions, but submit all reports to Nairobi. These include the critical repayment records, which must be sent by the first Wednesday of each month. KIE/ISP's computer person requires a week to input all of the data for each month. Management is currently satisfied with the turnaround time on its monthly monitoring information.

KIE/ISP uses its monitoring system to increase its "strategic thinking capacity" to assess its client base and institutional capabilities. This includes tracking their client's business assets growth, employment growth and change in value added.

The organization is making a concerted effort to move everyone, not just loan officers, to performance based contracts. They now serve 1,700 clients with 30 field officers and believe they can add 40 new clients per year per officer. They conduct periodic incentive schemes, featuring small prizes such as T-shirts and pen knives.

KIE/ISP's analysis of its basic client data and internal budget figures caused them to determine that they operate with an effective 34% subsidy, in a business climate of below market overhead costs but slow loan generation. 'What if' scenarios, changing interest rates, inflation, loan officer carrying capacity, overhead,

fixed, and variable costs, and other integral data, have provided a good picture of what it will take to make the program self-sustaining.

KIE/ISP would like to lower the administrative to field staff ratio to 1:2. it is now nearly 1:1. The placing of 10 new field officers currently in training will move the program much closer to its goal.

Role of Commercial Banks

As a government parastatal, under the bureaucratic control of two ministries, KIE/ISP's ability to deal with formal financial institutions is limited. Also, Kenyan commercial banks have done very little to lend to the market in which KIE/ISP operates.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and/or Challenges

- The Informal Sector Program (ISP) is linked to Kenya Industrial Estates (KIE) which is a parastatal organization. As a division of a GOK parastatal, ISP doesn't have sufficient operational independence and needs to become more autonomous.
- One problem related to being perceived as closely tied to the KIE bureaucracy is that some clients consider their loans to be GOK money which is political and doesn't have to be repaid.

- Because of this bureaucratic linkage, the loan disbursement process has become far too lengthy. Loan approval is completed in the field in one to two weeks. However, once the application enters the GOK bureaucracy it takes and average of about six months (180 days) to complete the 26 step legal processing procedure. KIE/ISP has identified this as their priority problem and is striving to cut disbursement turn-around time in half (90 rather than 180 days).
- Although the KIE/ISP program is funded separately, it is still seen as a division of the larger bureaucracy. Therefore, they are unable to hire and fire independently. Because of 100% government ownership, it is prone to political interference. ISP management, however, has been given a fair amount of leeway in the past two years and is trying to take advantage of the move toward "parastatal reform" to achieve the kind of independence needed to function more cost effectively.
- The current (18% in June 1992) interest rate is too low. It should be 32 to 35% to fully cover program expenses. The program now covers 66% of its recurring costs.
- Another problem is that fixed costs are too high. This is largely because the ratio of administrative personnel (40%) to field workers (60%) is to high. KIE/ISP wants the ratio reduced to one third administrative personnel to two thirds field staff.

- Clients are highly mobile and when tribal clashes or drought conditions generate tensions they can move back to their home areas. In some cases, these are people who have defaulted on their loans and don't want to be found by Field Officers seeking repayment. This is small number (less than 5%) of the portfolio.
- There is built-in tension between the Field Officers who are stressing the need for growth in earnings and the entrepreneurs who want more money but often don't want to grow.

Accomplishments Management Feels Good About

- KIE/ISP pleased with the results of its noninterventionist client development approach which puts the emphasis on learning rather than "giving" loans or "doing things for" their clients. This is accomplished by putting clients through a demanding series of client selection "hurdles". This has proved to be effective in weeding out insincere, unqualified and/or "political patronage" entrepreneurs.

  Clients fill in formats to monitor their businesses and do a business plan which includes listing fixed assets, inventory of finished and unfinished goods, fixed and variable costs and sales projections.
- Management is pleased with the way their monitoring systems in operating. It has been in place for only about 18 months, but it allows ISP management to know at any given time the number of loans out,

the gender of borrowers, repayment and arrears rates and names of the worst defaulters in a given region to be targeted for sanctions.

- KIE/ISP is also pleased with their sanctions procedures which allows them to "come down hard" on defaulters by repossessing their assets (a last resort), warning guarantors who pressure defaulter and/or initiating legal prosecution. They have never lost a case and currently have 80 cases pending.
- KIE/ISP is pleased with their staff training program and "fair" salary levels. Emphasis is placed on "personal development" and incentives (pocket knives, calculators and overseas training) are given out to reward outstanding performance. This has resulted in a low turn-over (lost only 3 Field Officers of 38 recruited), which is far under their staff turn-over target of 10%. Because their staff is well trained and experienced, they receive frequent job offers, but they stay with KIE/ISP although they do not have permanent nor pensionable positions.
- Management is also proud of their nationwide service delivery infrastructure which currently operates from 21 offices and provides an opportunity for flexibility and portfolio diversification.
- Impact studies are done on what sectors (tinsmiths, tailors, etc.) are defaulting on loans and whether this is happening in growing or stagnant market environments. This allows managers to adjust their

loan coverage pattern to avoid specific types of small businesses which are losing money because of inadequate markets. Loans for equipment purchases can also be tailored to avoid locations where their is an over concentration of specific production technologies (maize mills, etc.).

- The ISP program has a signed agreement with a German funding agency (GTZ) to provide adequate money for a sufficient time to build a foundation for financial sustainability after funding is discontinued.
- KIE/ISP takes satisfaction in having built a Kenyan management team with a well developed strategic planning capability. One indication of this is what KIE/ISP terms a Strengths, Weaknesses, Opportunities and Threats (SWOT) list which critically assesses its program development process. Another indicator is that operational procedures are clearly defined and communicated. For example, job descriptions are detailed and contain job performance indicators to enable monitoring and evaluation.
- Another accomplishment of this program is its ability to handle a large volume of loans. Presently, each of the 30 Field Officers can add 40 loans to his/her portfolio for a total of 1200 per annum. The program estimates that it could service a maximum of 3000 loans.
- When the program began, it inherited some 300 "dismal" loans some of which were seeking repayment through the courts and others were considered "dead". The current recovery rate is 84% of the loans due.

The system is also geared to increasing loan amounts by using more sophisticated business plans and advance marketing surveys. The system is also designed to facilitate "graduation" to commercial banks.

- KIE/ISP is also pleased with the results of their screening processes for hiring new staff. Applicants are given a three hour written exam, followed by an interview and a one day assessment center exercise. The whole selection process takes four days. During which applicants make oral presentations, role play different tasks within their job description and are assessed on their ability to work well in teams. Marginal cases are also given personality tests. This results in selecting approximately 15 of the 40 applicants who had been placed on the short list. The short list was derived through the interviews and exams from an initial list of 120 candidates.

Lessons Learned and Recommendations

- Work with established micro/small enterprises rather than start-up businesses which are more vulnerable to risks and have not demonstrated viability.
- Carefully analyze the target group of entrepreneurs you have selected to make sure your organization is well positioned to meet their needs. Be sure that you can do what is needed and don't try to be everything to everybody.

- Think of your organization as a bank which must operate profitably to stay in business, rather than as a sociai welfare provider focused on poverty alleviation. Take a tough-minded attitude toward loan repayment. Repossess collateral from defaulted loans publicly so that others who may be considering defaulting realize that you are serious.
- Stress long-term sustainability from the very beginning and see yourself as a permanent organization rather than operating in response to a short-term grant cycle.
- The strongest incentive to repayment is access to another loan. Clients should know that your organization encourages borrowers with good repayment records to request additional loans when they meet appraisal criteria. The higher loan amounts must be large enough so that entrepreneurs see them as significant yet affordable.
- Your program should be sensitive to gender issues. However, treat women as entrepreneurs rather than "poor, disadvantaged cripples" and they will perform accordingly. Your performance expectations must be clearly understood and applied without favoritism and/or exceptions.
- Provide incentives and express appreciation for staff members who go the extra mile and consistently do more work because they feel part of the process and share objectives.
- Making the loan approval process demanding will serve to weed-out insincere potential borrowers whose business plans reveal their profit

expectations are unrealistic and poorly thought out. This offers good protection against attempts to politicize access to loan funds.

- Hire the best available staff and pay them commercially competitive salaries so they can resist pressures by other organizations to hire them away. When salaries can't be raised because of ceilings, find creative ways to provide other incentive packages.
- Don't hire people with above average levels of education because their job expectations (salary, benefits, 8 hour days, etc.) that the job cannot fulfill. They only take the job as a secure financial base from which to look for another job which meets their needs. Is better to hire someone with a good basic education who can be trained to grow into a job which provides salary and benefits not otherwise available to them.
- When you are seen as organizationally aligned with a government bureaucracy, it is imperative that clients understand they are expected to repay loans and not consider that it's "free" government money. This is harder to do when your organization/program is perceived as an appendage of a government ministry. Client education about the way credit works and the responsibilities of accepting a loan repayment agreement is essential to clarify any misperceptions.

C. PRIDE

1. ORGANIZATIONAL BACKGROUND

PRIDE was established in 1989 under the aegis of The Council For International Development (CID), which is headquartered in Washington, D.C. PRIDE/Kenya is a minimalist credit program, currently operating three branch offices. PRIDE plans to expand to serve some 20 branch offices within the next five years.

PRIDE/Kenya has some 20 Kenyan staff members and two expatriate consultants from the Council for International Development. The program currently serves some 1,200 clients who are organized in Market Enterprise Committees (MECs) containing 15 to 50 members.

The average PRIDE client owns a microenterprise whose average monthly sales volume is US $370 and net profit is US $74 dollars. The majority of the enterprises (61%) are sole proprietorships and the rest have between one and two employees.

A recent survey showed that 42% of PRIDE'S clients are women and 25% of them are heads of households. Almost two thirds (64%) have no source of income other than their businesses.

2. PROGRAM SERVICE DELIVERY METHODS

Recruitment/Hiring Criteria and Practices

PRIDE recruits its field loan officers from high school grads which are in plentiful supply in Kenya's recent soft job market. They recruit individuals with good personal communications skills who can learn the PRIDE system quickly. PRIDE pays competitive salaries and has experience rapid turnover in its field staff.

New trainees are trained and tested over a period of three months, most of which is in-service training which takes place in the branch offices. Trainees are assessed in eight types of performance areas. PRIDE has produced a manual for its staff training and is considering hiring someone to further up-grade their training program.

PRIDE hires college graduates to fill its Branch Manager positions and provides a benefits package, including housing allowances which have tax advantages.

Client Targeting/Selection and Screening

PRIDE has targeted existing rather than start-up rural microenterprises whose owners do not have access to credit from commercial banks. Groups of five self-selected members are responsible for repayment of the loans they receive. Approximately 10 of these five member groups in one geographic area form a Market Enterprise Committee (MEC) which has about 50 members. The MEC meets weekly to collect the savings and loan repayments from its five person sub-committees.

PRIDE has established offices only where a Barclay's Branch is available to transact business. The criteria for office location includes an area population of

20,000 which has a significant number of local businesses within a radius of five kilometers. This is to provide a sufficient concentration of borrowers so that it is cost-effective to establish a branch office and form MEC committees.

For the first loan, which has a limited of Ksh 5000 (about US 160), screening and selection is done primarily by group members. The group evaluates whether the borrower needs the loan and can repay the amount requested over 50 weeks. Borrowers with good repayment records can get subsequent loans in increments of Ksh 5000.

PRIDE is using this system of incremental loans as a strategy to weed out any poor borrowers early when they have small loans and as a means of teaching new borrowers about credit. PRIDE plans to keep good clients in their portfolio until their needs grow beyond Ksh 30,000.

Everywhere PRIDE operates they have mobilized local leaders to help promote the program, provide references for potential borrowers and provide help in collecting overdue loan repayments.

Loan Application Design and Implementation

The application process is performed by the groups as explained above. PRIDE emphasizes the need to be careful not to rush group formation because they must understand the loan process, how banks operate and their responsibility to repay.

The process requires that the group save Ksh. 50 weekly for a minimum of 8 weeks in a "Loan Insurance Fund" which acts as a loan guarantee and can be

accessed to cover defaults. PRIDE assists new borrowers to establish individual bank accounts at Barclay's bank into which their loan is disbursed. Other savings are encouraged but voluntary.

Loan Portfolio Management Policies and Procedures

PRIDE has an overall long-term plan for breakeven and financial self-sufficiency. This plan calls for expansion over 5 years to 20 branch offices in Kenya. Each PRIDE branch office is projected to cover its own operating costs within 1 to 1.5 years and then start contributing to head office costs. , which spread over 20 branches will allow breakeven.

PRIDE is carefully developing a standardized branch office replication procedure which includes criteria for location, staffing, number of clients, loan volume, costs, operating policies and procedures.

PRIDE is developing a portfolio at each branch following the same strategies which are designed to generate good credit habits during the first loan period. From this group a high percentage are expected to be repeat borrowers taking increasingly larger loans until they reach their maximum level. This is expected to generate a growing portfolio that becomes increasingly less risky .

Non-Financial Program Service Delivery

Recently, PRIDE has adopted a new business training scheme. PRIDE's clients can purchase coupons for 20% of their value, which can be used any training

institution or organization to take courses. PRIDE expects some of its clients to seek training that will improve their basic business skills, although it is too early to know how clients will decide to use the coupons.

Program Monitoring Procedures

PRIDE monitors group loans at weekly MEC meetings then manually reports to a central computerized system at its head office. In addition, baseline information is collected on all borrowers prior to their loan.

PRIDE has also compiled a total of 20 detailed case studies to analyze impact and also done surveys of its poor performing and drop-out borrowers. PRIDE also collects follow-up data on all of its clients using a standard information collection form which provides data for client progress reports. PRIDE found that some 40% of these follow-up data forms had to be redone which identified the need for training of field officers to do this task properly.

Board of Directors Composition and Role

The Council for International Development (a US NGO) formed an initial five person Board Of Directors for PRIDE. A.I.D. has made a grant to help PRIDE expand the board in preparation for a more financially independent future. An expanded PRIDE board will be a critical link to financial sources of both grant, concessionary loan, and commercial credit.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Overview: PRIDE uses self-selecting, regionally-based groups to facilitate loan disbursement, monitoring and repayment. The organization receives part of its loan financing from K-REP, and a significant amount from Barclay's Bank.

Loan Fund Terms and Conditions

PRIDE, has two loans with K-REP. One is a Ksh 1 million loan at 5%, with interest payments monthly over five years and a balloon principle repayment at the end of the term. The second loan is at 7% over five years for Ksh 5 million, requiring monthly interest payments and a balloon principle payment at the end of the term.

PRIDE also has two loans from Barclay's Bank to finance its lending. The first is a Ksh 1 million loan at 0% interest to be repaid over five years. The second is a Ksh 1.5 million loan at 5% interest over five years, which calls for semi-annual interest payments and a balloon principle repayment at the end of the term. PRIDE expressed satisfaction with both the liquidity and pricing of its current loan funding base.

These soft loans have been made through Barclay's not for profit Small Business Unit (SBU), which has the backing of a 100% loan fund guarantee by

external donor organizations. The SBU's finances primarily come from a bank development fund created from 1% of the bank s profits.

PRIDE also has a grant from USAID for institution building, which helped defray some overhead costs and allowed the organization to hire more Kenyans for key management positions.

Loan Interest Rate Policies

PRIDE charges 27% on declining balances on loans starting at Ksh 5,000 per person. The effective rate is closer to 30% p.a., since the real rate is 25% over the 50 week repayment period. The period was set at 50 weeks to facilitate computation of loan payments and internal accounting.

Loan Disbursement Procedures

PRIDE disburses loans and encourages repayment through Enterprise Groups of five people, who have selected their membership. Ten groups of five are then organized into structures called Market Enterprise Committees (MECs). Currently there are 15 MECs receiving credit from PRIDE.

Following eight weeks of orientation, mainly from the field credit officer, groups can become eligible for their first loan. During this period, the loan officer does spot checks and community inquiries to determine whether group members currently own an income generating enterprise. Informal studies by PRIDE indicate

that only 3% of their clients did not actually have a business, and used the loan for start up purposes.

PRIDE headquarters writes one check to the local Barclay's Bank in the region where the group is located and tells the bank branch who will receive how much money. Group members then go to the bank to withdraw their funds. Two Enterprise Group members at a time are authorized to obtain credit. All group members will have received their first loans 16 weeks after forming a group, choosing their leaders and going through orientation.

Subsequent loans, usually disbursed in Ksh 5,000 increments, are contingent upon a history perfect repayment, peer assessment of the borrower's reliability and the economic viability of his/her activity. Approximately 70% of loans go for wholesale, retail, and hawking activities. As of April 1991 PRIDE had disbursed 1,323 first loans, 462 second loans, 72 third loans, and 6 fourth loans.

Five clients, who have reached the Ksh 20,000 loan level, will apply for security free credit directly from Barclay's Bank in an effort to move the best and biggest clients into the formal financial sector.

Loan Repayment Collection Procedures

At the weekly group meetings, the treasurers of the groups and the MECs collect the payments from individuals. The MEC treasurers give the cash and receipts to the local PRIDE credit officer, who makes a deposit in a PRIDE account at the local Barclay's branch. PRIDE credit officers attend group meetings to assess group

dynamics, learn first hand who has and has not paid and to strengthen rapport with their clients. PRIDE has great faith in the power of the group to pressure its members to make payments.

PRIDE requires that its members contribute Ksh per week to a Loan Insurance Fund (LIF). Payments are collected at the same time as loan repayments. Each of the three PRIDE branches has a local bank account into which the credit officer makes the deposit. The LIF currently provides an average of 20% bad debt coverage.

PRIDE explicitly places its branches in rural population centers with at least 20,000 people and 2,000 enterprises within 5 km of the town center. In its early stages, PRIDE located its branches within about a 2.5 hours drive of Nairobi to allow tight monitoring and a timely basis. Proximity also hastens loan disbursement and other banking transactions which are largely done from the main office.

Loan Arrearage and Default Practices

PRIDE has established a rating system for its borrowers. "A" borrowers have a perfect repayment and group meeting attendance record. "B" clients have missed less than five payments or meetings. "C" borrowers have a probationary status acquired after having fallen from "B" to "D".

"D" clients have missed more than four payments, which means their LIF funds are seized and they are expelled from the group. They can move back into "C" status by bringing their loan payments up to date and obtaining the approval of group members. They can never regain an "A" or "B" rating.

Five cumulative weeks of individual, group, or MEC arrears brings a default classification. However, PRIDE records two month non payment (60 day arrears) as bad debt on their balance sheet.

At this point, they request the assistance of district officials to sanction delinquent debtors through threat of legal action and public notice of default. PRIDE has also experimented with using local police forces to collect bad debt. The police receive 10% of whatever portion of the bad debt they can collect.

PRIDE has lent Ksh 18 million since 1989. They have written off (for accounting purposes) Ksh 800,000. However, they still pursue this money to reinforce the perception that PRIDE considers repayment a very serious matter. At its worst branch, PRIDE has a portfolio at risk of 19.5%.

Loan Program Accounting Procedures

Field officers keep manual records of loan repayments, LIF contributions, loan eligibility, and narratives on personal and business profiles. Receipts for loan repayments and LIF money, along with tracking and monitoring sheets are sent to PRIDE's Nairobi headquarters on a five day delay basis. Headquarters personnel then enters the data on to PCs.

The system produces repayment reports at an Enterprise Group, MEC, and individual level. Loan officers also watch individuals themselves through attendance at group meetings and periodic site visits. PRIDE encourages but keeps no formal record of voluntary savings on the part of members. The MIS computes average loan

size and repayment rates. It also keeps track of program census data such as number or groups, number of active clients, etc.

PRIDE feels comfortable about its ability to analyze branch cost recovery performance. They estimate that a branch requires one year to generate enough loan business and establish its cost structure before it can begin to break even. After fourteen months, management expects the branches to begin contributing to overhead.

PRIDE would like to implement an incentive scheme for its credit officers and eventually the rest of the staff. However, they pointed out that few institutions in Kenya, public or private, have incentive plans. PRIDE does offer its staff a standard package of benefits, which includes off-book, lower taxed housing allowances.

Role of Commercial Banks

Barclay's Kenyan Managing Director sits on PRIDE's Board of Directors, which has facilitated the negotiation of some of the financing and branch services offered by the bank to PRIDE.

Barclay's risk exposure to PRIDE is minimal because the financing it has offered is concessionary and comes from a not for profit unit within the bank. However, the bank does provide some important branch services. Most notably, the bank allows PRIDE clients to open an account with a minimum balance of Ksh 100, instead of the standard Ksh 500. The branches also allow PRIDE clients the privilege

of making four withdrawals per month. Barclay's branch personnel also sometimes attend group meetings to teach PRIDE clients more about banking.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and/or Challenges

- The first branch office ran beautifully for the first year. There were no defaults and no arrearages. However, problems (arrearages) appeared about six months later when clients became tired of going to weekly meetings and discipline suffered.
- The original loan appraisal system was not adequate because it has been learned that most of the loans were not used for the stated purpose. Field visits were only made to verify the second loans. The first were made on good faith.
- PRIDE over-recruited in some villages without sufficient attention to the business background of some applicants, many of whom were housewives without enterprises. Recruitment was also done in some small, sparsely populated areas without adequate markets to absorb the production of small scale enterprises.
- PRIDE acknowledges that staff training is currently its "weakest point" and is currently in the process of recruiting a training manager. Newly hired staff members and been sent to work in PRIDE's branch offices

and received on the job training (OJT). The result was that trainees picked up the bad habits of the branch officers who trained them, which resulted in replicating all of the problems found in that branch. PRIDE is currently producing a training manual to better standardize and monitor the training process.

- There is an on-going Kenyan NGO practice of "poaching" skilled staff members, which can result in the loss of key personnel and disruptions in service delivery as a result of time lost in training replacements. What is needed is a strong staff incentive and benefit program which can provide goods and services which are not taxable. Personal income taxes in Kenya are high (40 to 45% in some cases).
- PRIDE reports that there is a need to improve their data collection and processing ability. For example, the response to a recent survey of their branch offices was unacceptable. 40% of the questionnaires had to be returned to be redone.

Accomplishments Management Feels Good About

- PRIDE explained that the organization feels good about the results of a recently completed impact assessment. Employment generation (full time, paid workers) was up 10% in PRIDE assisted firms which had received two loans. The average net profit of these firms increased by

43% after two loans and the value of basic assets had increased by 54%.

- PRIDE is currently testing a very innovative approach to training and technical assistance in which borrowers who repay their loans on time receive subsidized services. The client can purchase a coupon for 100 Ks which can be redeemed for 500 Ks worth of training. The client can select the type of training he/she wants from an approved list of local training and T.A. organizations.
- PRIDE has learned that hasty recruitment creates problems. They recommend designing a demanding training program which self-selects candidates by weeding out those without basic management expertise whose unrealistic business plans identify them as poor risks.
- Impose discipline on the groups with whom you are working. For example, clients who are ten minutes late for meetings are fined. In one case, a manager was late and was fined accordingly.
- Don't recruit clients within a wide radius (30 kilometers is excessive) of the branch offices. Clients should be located within walking distance (5 kilometers) from the branch offices to reduce the high cost of transportation. Cars are not provided to branch office managers as a further means of limiting the program's coverage area.

- Field Officers should be literate, numerate and have the interpersonal skills required to train, communicate effectively and resolve conflicts before they escalate into major problems.
- Begin by making loans to groups because this helps reduce operating costs for covering a large number of borrowers making small loans. However, larger second and third loans can be made to individuals with good repayment records who may subsequently to graduated to commercial bank loans.
- There was an initial expectation that women would out perform male borrowers. However, the number of defaulters has proven to be roughly the same.
- Provide staff performance incentives on which they are required to pay either no taxes or a reduced amount. For example, a staff housing allowance is taxed at 15% rather than the 40% tax on earned income.
- Some clients borrow money from a local informal credit mechanism (merry-go-round) to pre-pay their PRIDE loans thereby qualifying for larger loans. PRIDE believes this practice contributes to defaults because borrowers become over-extended on the basis of an artificial credit history. The lesson here is that careful monitoring is needed to determine if the client's enterprise is really viable or if he/she is borrowing money to make loan payments.

- When the US Ambassador and/or other visiting dignitaries make speeches endorsing PRIDE it often has the unintended consequence of causing borrowers to view their loan as US money. That means people then consider that repayment isn't required. PRIDE funds are handled through a local bank and the client's perception is that their loan is bank money not US funds. Educate people to the unintended negative consequences of their well intentioned public comments endorsing and promoting this type of programs.
- PRIDE has recruited local district police to collect loan payments from people who have defaulted. The police are given 10% of whatever loan funds they are able to recover. Although this approach would have serious problems in some African countries, PRIDE has found the experience to be productive.

II. SENEGAL

A. AGENCE DE CREDIT POUR L'ENTREPRISE PRIVEE (ACEP)

1. ORGANIZATIONAL BACKGROUND

Organizational History

Since June, 1985, Agence de Credit pour L'Entreprise Privee (ACEP) has been funded by United States Agency for International Development (USAID) through the Community Enterprise Development (CED) Project. This project is now on its fourth amendment. This will bring its total funding to $15,229,000 and extend the project through December, 1993.

The original design called for a $9 million project in the Kaolack and Fatick regions of Western Senegal to provide assistance to small-scale enterprises, private voluntary organizations, and village organizations. Since January 1991, when the project dropped its PVO component, ACEP has concentrated solely on the provision of credit for small and micro enterprises.

In 1990, ACEP moved its headquarters from Kaolack to Dakar and began expanding its network of regional and local offices. From its original two offices in Kaolack and Fatick, ACEP has expanded to four regional offices and nineteen local offices in a total of eight regions. ACEP's regional coverage now includes Dakar, Thies, Kaolack, Fatick, Louga, Ziguinchor, Kolda, and Tambacounda.

Since the arrival of Nicolas Rofe as project director in October 1989, financial management of ACEP has been improved. At that time, USAID/Senegal was considering closing the project, following an audit of the Kaolack office which revealed that $15,000 was unaccounted for because of financial mismanagement and/or poor record keeping. At that time, the project had only made about 300 loans and it was necessary to write-off 36.5 million CFA ($146,000) as losses. Because record keeping was poorly organized, it took the new team approximately 2 months to reconstruct client files, establish correct outstanding balances, and produce ACEP's first financial statements.

Since 1989, management has turned the organization around completely. In three years ACEP has doubled the size of its financial network, increased the quantity of its loans by 300%, decreased loan losses from 11% to 2% and increased loan revenue by 370%. From 1990 to 1991, ACEP increased its lending by 158%, from 398 million CFA in 1990 to over 1 billion CFA ($3,950,000). Gross revenues increased by 223%, from 42,687,000 CFA ($170,000) in 1990 to 137,942,000 CFA ($552,000) in 1991. By the end of FY91, ACEP had created 1,301 new jobs and helped preserve 4,500 existing jobs.

Organizational Goals and Objectives

ACEP's project objectives are to provide secured commercial loans to Senegalese small and medium size private enterprises without access to formal bank credit. Loans may be used to finance expansion of working capital or investment. Loans for working

capital or investment will be made on conditions and terms that assure the financial viability of ACEP, which will be transformed into a permanent financial institution (credit union) by the end of 1993.

2. PROGRAM AND SERVICE DELIVERY METHODS

Staff Recruitment and Hiring Criteria and Practices

ACEP management believes that staff recruitment is the key to good client selection, which is the basis of the program's success. ACEP recruits its staff on the basis of motivation, responsibility, good judgement and the ability to adapt to ACEP's corporate culture.

ACEP never hires employees who have worked for the Senegalese government, a bank, or another development project. They reject candidates who come to ACEP with the cultural baggage of the bureaucratic elite. ACEP looks for staff members who will take individual responsibility for their actions.

There are no educational requirements other than a high school diploma. ACEP recruits "people who understand people" rather than on the basis of academic degrees or other credentials. For example, the current manager of one of ACEP's Dakar branches was formerly a guard at ACEP headquarters who showed interest in ACEP's business, asked good questions, and had a good relationship with ACEP's clients. He was given the chance to attend a training session and was eventually recruited as a branch manager.

ACEP's corporate culture is based on the decentralization of responsibility and authority, coupled with a profit sharing incentive system through which its staff can receive a percentage of the branch's net profits. Branch managers earn a bonus of 5% of their portfolio's net profits. The bonus can total as much as seven months salary.

Staff trainees spend one month each in three different ACEP field offices and one month at ACEP headquarters. Trainees are evaluated by the branch managers with whom they work, and the best are considered for available full-time staff positions. Trainees receive a stipend of 20,000 CFA a month ($80).

Client Targeting, Selection Criteria, and Screening

ACEP uses three selection criteria to determine which potential borrowers will be willing and able to repay their loans:

- The loan applicant must work full time at their business;
- They must have an established, profitable business with no bad debts; and,
- The loan must be secured with easily recoverable collateral.

ACEP Branch Managers are required to visit a loan applicant's home and work place to get to know a potential borrower and their business. Maximum loan size is 3 million CFA ($12,000). ACEP avoids lending to large businesses or influential people. Seventy percent of ACEP's borrowers have a primary Koranic school education and few have a formal secondary education.

The goal of ACEP's current lending policy is to create value added and new jobs by directing loans to smaller enterprises. Enterprises with less than 10 employees make

up 96% of ACEP's loans, and 88% of these enterprises have assets of less than 5 million CFA ($20,000). ACEP lends to all economic sectors, but since 1989 it has decreased its lending to agriculture and commerce, and increased its financing of the service sector, particularly transport. This was done to reduce systematic risk tied to the groundnut crop. With this in mind, loans to agriculture decreased from 12% in 1989 to 6% in 1991, and commerce loans decreased from 44% to 27% of the ACEP's loan portfolio in the same period.

ACEP began making group loans in 1991 and has found that repayment rates for these loans are no worse than for individual loans. At present two and a half percent of all loans are issued to solidarity groups.

Table 1

Evolution in the Composition of ACEP's Loan Portfolio

	1989	1991
Loans for agriculture	12%	6%
Commerce	44%	27%
Manufacturing	9%	17%
Services	28%	44%
Loans 50,000-500,000 CFA	6%	32%

Loans above 2,000,000	47%	15%
Number of loans to women	10%	23%
Volume of loans to women	5%	11%

From the beginning of the project to September 30, 1991, ACEP issued 2,142 loans for over 2 billion CFA ($8,000,000). In FY91 alone ACEP lent more than 1 billion CFA with a 98% reimbursement rate.

Loan Application Design and Implementation

Branch managers are directly responsible for each loan they make. They are required to help the borrower to prepare a basic financial statement and to verify, in person, all loan information provided by the borrower. The same ten page application form is used for all ACEP loans to analyze credit worthiness and the character and collateral of the borrower. The loan application form requires the entrepreneur to provide a detailed description of themselves and their business. This includes the entrepreneur's education level and business experience plus the enterprise's management structure and technical capacity.

A market analysis is required for every loan, as well as a detailed description of the enterprise's assets, liabilities, sales, profit levels, expenses, taxes, debts and credit history. A 15 month spreadsheet of projected expenses and revenues is prepared. The enterprise's liquidity, stock rotation and profitability ratios are also calculated.

After the branch manager approves a loan application, it is passed on to the regional manager for analysis and then to ACEP's credit committee for approval or rejection. In a typical month, a branch manager receives about 100 loan applications, 25 of which are passed on to the regional manager and, with his approval, submitted to the credit committee. A loan is approved by the credit committee only by unanimous vote. No one on the committee is required to explain why he or she disapproved a loan and the prevailing philosophy of the committee is "when in doubt vote no." ACEP believes there is no reason to take on risky loans when there are many other good borrowers who need the money.

Loan Portfolio Management Policies and Procedures

ACEP's credit committee is made up of managers from each region and ACEP headquarters who meet once a month to approve loans and to analyze the portfolio. A monthly financial report is prepared by the accounting office which contains data on loan volume by sector, arrears and defaults. On the basis of this monthly reports, the credit committee can tailor ACEP's loan portfolio to target certain sectors or client groups. Monthly financial reports also tell regional managers if their portfolio has become too heavily invested in one particular sector and needs to be diversified.

Non-Financial Program Service Delivery

ACEP does not offer non-financial services to its clients and makes a specific point of not suggesting how and where they should invest their loan. ACEP has

collaborated with other organizations offering technical assistance and training, but it specializes exclusively in credit delivery.

Program Monitoring Procedures

The key strength of ACEP's lending methodology is its ability to simultaneously monitor individual loans and a large loan portfolio through results-oriented, decentralized management. Branch managers are expected to know their clients and to visit their homes and places of work. Loan performance information from branch managers is entered into ACEP's computerized accounting system and the financial statistics of each branch are analyzed once a month.

Board of Directors Composition and Role

As a USAID funded project, ACEP has no official board of directors. It is currently overseen by both a USAID project officer and the Senegalese National Project Committee (NPC) which has general oversight responsibility for all USAID projects. The NPC must approve any major changes in project implementation or policy, but does not interfere with ACEP's day to day operations. For example, ACEP had to seek approval from the NPC when they increased their interest rate from 24% APR to 28% APR.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Loan Fund Terms and Conditions

ACEP limits credit to existing enterprises which have demonstrated profitability and good financial management. The client's character and the strength of their loan guarantee are the key factors on which ACEP bases its lending decision.

Loans are limited to a maximum period of 16 months and a total of 3,000,000 CFA ($12,000) for the initial loan and 5,000,000 CFA ($20,000) for subsequent loans. Payments are made on a monthly basis, due before the fifth of the month. ACEP's interest rate is currently at 28% APR with a 1% service fee for loan processing. Though this is 6% above the prevalent bank rates, ACEP's total cost of credit, when bank fees and commission are counted, is below prevalent bank costs.

All loans must be collateralized. ACEP will only lend up to 75% of the value of the collateral guarantee. ACEP accepts a wide variety of collateral (machinery, vehicles, houses, gold), but prefers goods that can be easily reclaimed and sold in case of default. Receivables have been accepted as collateral. For example, when the borrower can provide written proof they have a sales contract, ACEP will accept payment from the buyer, deduct the value of the loan, and return the remainder to the borrower. In such cases ACEP charges a 3% commission for the increased risk entailed.

Loan Interest Rate Policies

ACEP lends to its clients at 28% APR plus a 1% opening fee. Most commercial banks offer a lower interest rate, usually around 22% APR, but then charge a 2.5% opening fee, a 2% quarterly overdraft fee, and a 5,000 CFA ($20) monthly account

service fee. The result of this combination of add-on fees is that ACEP loans are usually cheaper than commercial loans. For example, under the ACEP system total finance charges on a 1 million CFA loan would equal 170,000 CFA; a bank would charge 218,000 for the same loan.

Loan Disbursement Procedures

Before they receive their money, ACEP clients must pay 1% of the loan as a processing fee, and present proof that they have a life insurance policy equal to the value of the loan capital plus interest. ACEP has had to use these life insurance policies eight times to repay the loans of deceased borrowers. Borrowers cannot pay for policies using money from the ACEP loan. After the insurance premium and processing fee has been paid and the collateral registered, ACEP notifies the borrower to appear in person to collect their check.

One month after the loan is disbursed, branch managers are required to visit their client to ensure that the loan money was spent in the agreed upon manner. The branch manager confirms this to ACEP headquarters in their investment report.

Loan Repayment Collection Procedures

The payment due date is strictly enforced and loan repayment procedures are clearly explained to potential clients. Clients close enough to one of ACEP's 4 regional offices must make payments to the regional cashier. Clients located too far to easily reach a regional office are allowed to repay their branch manager. Only four ACEP

branches are considered isolated enough to allow their branch managers to accept loan repayments. Those branch managers who are allowed to accept payments, but they may only hold up to 3 million CFA ($12,000) and must deposit payments with a regional cashier within seven days.

Clients are told to always demand a receipt for payment either from the regional cashier or their branch manager. In the case of any discrepancy, borrowers are held responsible for repayment if they cannot produce a receipt. To test its receipt system, a monthly statement is sent to ten randomly selected clients from each branch and they are asked to certify that the statement is correct. An annual statement is sent to each ACEP borrower as well as a statement when the loan is paid off.

Loan Arrearage and Default Practices

ACEP has developed strictly enforced arrears and default procedures which are explained to potential clients. ACEP considers a payment late if it is turned in after the fifth of the month.

If a client does not pay before the end of the month, they receive a visit from their branch manager. If they do not pay the next month, they receive a visit from the regional manager who explains the legal recourse in the case of non-payment. If, after three months, the client has still not paid nor arranged a payment program with their branch manager, the loan is considered non-performing. ACEP's legal department then contacts a lawyer to repossess the client's collateral. Most clients repay their loan before

ACEP seizes their collateral. Through strict enforcement of this system, ACEP has been able to maintain arrears at 4.5% and defaults at 2% of their portfolio.

Loan Program Accounting Procedures

ACEP uses a standardized manual accounting system in its field offices and a sophisticated computerized accounting system in its Dakar headquarters to track performance of its over 2,300 active accounts.

The computerized accounting system at ACEP's headquarters was developed specifically for their needs. Records in the system are updated at the close of business every day and a loan portfolio report is issued once a month. ACEP management is able to print out reports at any time analyzing their portfolio by branch, loan size, economic sector and sub-sector, or by the name, age, or gender of the borrower. Loan officers are also able to check on individual defaults and arrears.

On staff at ACEP's Dakar headquarters are a computer programmer and a data entry person whose responsibility it is to maintain the system. After a record is entered into the system, the system manager is the only person with the authority to change it, and only with the approval of ACEP's director general. This allows easy access to the system for management purposes, but ensures that records cannot be altered without approval.

ACEP does not rely entirely on the computer to verify its accounts. Every month, the accounting office checks computerized records against manual records to ensure their accuracy. Loan agreements, repayment receipts, check orders and canceled

checks are all verified and cross referenced against bank statements, manual journals, and computer print-outs.

Role of Commercial Banks

Because ACEP receives its funds from international donors and the government of Senegal, it does not seek to leverage loan funds from banks nor establish guarantee funds through them. ACEP management views commercial banks only as useful places to deposit surplus funds. Several Senegalese banks have gone bankrupt over the course of the last 5 years, so ACEP has been careful to diversify its accounts in reputable banks.

ACEP has no desire to "graduate" its borrowers to commercial banks. It regards itself as a bank specializing in SME lending and sees no reason to pass on its best clients to commercial banks. ACEP will carry good clients for the rest of their lives if they continue to maintain a good loan repayment record. Only about 10 to 15% of ACEP's manufacturing clients are capable of graduating into the modern sector where they would need large commercial bank loans.

4. INSTITUTIONAL DEVELOPMENT ISSUES

Problems, Constraints and Challenges

With USAID direct funding ending in December 1993, ACEP is currently preparing to transform itself into an autonomous and legally independent Senegalese financial institution. ACEP is lobbying the Senegalese government to become a credit

union, with all ACEP borrowers becoming credit union members. The new ACEP credit union will arrange to buy the old ACEP project's assets from the government at a discount over a 10 year period. As a credit union, ACEP will keep the same acronym and logo, but will change its name to the Alliance du Credit et de l'Epargne pour la Production.

Though credit unions currently have no legal status in the West African Monetary Union (WAMU), the Senegalese government is in the process of developing a legal definition for credit unions as financial institutions, and expects to have this definition completed by April 1993. If the legal framework for ACEP to become a credit union is not in place by the time USAID funding ends, ACEP will ask the government of Senegal for temporary status as a credit union or as a non-governmental organization. In the mean time, ACEP has already prepared its articles of incorporation, its internal regulations, its credit union statutes, and selected its charter members.

The following are some of the problems, constraints and challenges which the ACEP program has confronted since the new management took over in 1989:

- The original Kaolack program had a "project mentality" which had to be replaced by a private sector mindset. Emphasis was placed on increasing profits and decreasing costs. Expensive expatriate personnel were replaced by qualified Senegalese staff. The staff was reorganized to produce efficiency and action rather than studies and reports.
- The ACEP's loan volume had to be significantly increased because the original loan portfolio was too small to generate adequate profits.

- The USAID Regional Inspector General's Office sometimes tends to overreact when auditing the project. In ACEP's view a project should not be closed down just because a clerk steals money. The issue should not be whether someone has stolen money; the issue should be how quickly the financial control system can detect and correct the problem. ACEP knows within 24 hours if cash has been received and not deposited.
- The Senegalese legal system is complex, convoluted and prone to corruption. Cases for repossession of collateral can be infinitely postponed because of one legal technicality or another. One case was recently adjourned and rescheduled 26 times, after two years it is still pending with no end in sight.
- Under the Senegalese legal system, bailiffs have the authority to confiscate collateral in cases where borrowers default on loans. However, some corrupt bailiffs can receive bribes and conspire with prosecutors to thwart the legal process. Bailiffs can also pocket repayments and claim they never received any money.

  Often bailiffs do not follow required auction procedures and do not advertise the sale of assets properly, thus ensuring that only their friends or relatives show up at the auctions where they are able to buy the assets at a fraction of their true value. ACEP has several law suits against bailiffs for fraud and embezzlement.

Significant Accomplishments

- ACEP has achieved a 98% loan repayment rate. Part of this is because ACEP branch managers personally verify loan application data by visiting business sites and homes. This type of follow-up provides data which could otherwise have been exaggerated or falsified in loan applications and/or business plan.
- ACEP has an excellent computerized financial management system which gives them accurate up-to-date data on loan balance, date and amount of repayments, type of business, products, value added, gender of owners and employees, business type and location. A complete computer profile of the borrower is instantly available, which is updated daily with new data from branch managers and cashiers.
- ACEP fills an important need for SME credit and has established a very high level of customer satisfaction. Clients are now able to get a yes or no response from ACEP on their loan request in 25 days. Commercial banks require a six to nine month turn-around time. ACEP's clients are also able to do businesses in a bribe-free environment. Any accusation of bribery is quickly and thoroughly investigated by ACEP.
- ACEP has found that it can function as a Senegalese-managed credit institution without bad debts nor repayment grace periods. Senegalese branch managers have the autonomy to make their own management decisions without interference from headquarters, provided they can operate profitably.
- ACEP is pleased that it is making a smooth transition from a USAID project to the largest credit union in Senegal with over one billion CFA in assets. It is

currently able to pay all of its Senegalese operating costs without funding from USAID/Senegal. European donors have expressed interest in ACEP.

- For the first time ever, the government of Senegal has made a large grant to a development project, ACEP, but will neither own any of the organization's assets nor make any of its management decisions. The government has not interfered in the internal management of ACEP and has not enacted policy nor procedural constraints which hinder its operational effectiveness.
- ACEP provides loans on better terms than those available from merchants offering supplier credit. Supplier credit binds small business owners to one source of goods, without the opportunity to bargain over price or reject low quality goods. When goods are in short supply, suppliers first sell to their cash customers and credit customers have to wait. This often means getting goods after the peak demand period has passed.
- ACEP is pleased that its staff morale and sense of ownership is very high and that employees express pride in working for ACEP. ACEP has worked to develop a unique identity through use of corporate logos, signs, and even a corporate architectural style. The headquarters staff has organized an ACEP soccer team, and employees recently used personal funds to purchase key chains which have a large ACEP logo and their names carved on it. The idea to make the key chains came from the employees without consulting management.

Lessons Learned and Recommendations

- The key to success is unrelenting pressure to repay and the ability to get accurate financial information and to act on it rapidly. Don't let arrears drag on.
- It is best not to explain to an applicant why his or her loan application was rejected. To do so will lead to endless discussions and request for a review of the application. It is best to make a firm decision and go on to the next applicant.
- Don't give technical assistance to clients on what type of goods or equipment to buy. For example, if you recommend what type of water pump to buy and it performs badly the client will hold you responsible for his/her poor choice.
- Check with people in the local community to see if the loan applicant has a good reputation for paying his/her bills on time.
- Staff must have a strict business orientation. Entrepreneurs will respect you more if you are seen as someone whose job is to make money rather than to do social work.
- Management should work to build a disciplined staff which takes direct responsibility for their decisions. If they are in doubt about a loan they should say no, rather than later making excuses, claiming they had doubts or mental reservations.
- Management must create a professional working environment and insist on a high level of discipline. All employees must work eight hours a day, rather than operating on flex time or attending endless meetings. ACEP forbids personal use of office equipment and expects staff to reimburse the cost of any personal phone

calls. Eating and drinking are not permitted in ACEP offices. Management and staff alike must follow the same set of rules.

- Don't waste time writing memos. Managers must make decisions and take responsibility for those decisions, not waste time in consensus seeking when their are decisions to be made.
- Don't be intimidated by laws designed to put obstacles in your way if you want to fire someone for just cause. When you are in the right, hire a good lawyer and go ahead with the firing even at the risk of being sued. Make provisions in your financial statements for such contingencies. Don't let the threat of a law suit intimidate you into keeping non-productive people.
- When dealing with USAID, the government or anyone else, lines of authority must be clearly understood. Make sure there are no back channels of communication. You do not want an organization in which several people somehow appear to be in charge. Make it absolutely clear who is in charge and that all agencies must deal directly with that person. Any ACEP staff member who by-passes management and provides information in a clandestine manner should be fired. Any agency which doesn't trust ACEP's top management for whatever reason should clear up the problem directly or stop doing business with ACEP.
- Constantly maintain a supply of trainees so that non-performing staff members can be replaced or the staff can be expanded without decreased productivity.

- Attach a sheet to the loan application which is signed by the branch manager and checked by the regional supervisor affirming that both the business and home have been visited. Do this for every new loan rather than assuming that the conditions noted in a prior field examination remain unchanged.
- ACEP only gives loans to businesses which are doing well. ACEP is not here to salvage businesses in trouble.
- Do not overextend your capacity to manage and recover your loans. ACEP has currently approximately 4,000 clients and, for the moment, is not looking to expand dramatically.
- ACEP is not in the training business, instead it networks with local training providers who have good track records. It is best to let each organization do what it does best. ACEP does lending and it wants to concentrate on that alone.
- Avoid potential pressure from host country governments by keeping the loan amounts small (the average ACEP loan is $3,200). This avoids attracting the attention of politicians who are interested in larger loans ($100,000 and above) and grants. ACEP accepts loan applications from people referred by politicians on condition that they fully comply with established criteria.
- ACEP has on several occasions hired women as branch managers. Unfortunately the experience has not been satisfactory. These women managers felt unsafe on motorcycles and refused to use them. They were also exposed to frequent advances from male clients. In the informal sector in general men have difficulty accepting women in important roles.

- Staff education and prior experience are considered less important than a commitment to ACEP's success and a willingness to work hard. A good manager must be a detective able to get good first-hand information on prospective borrowers. ACEP's staff tend to be making more money than they had before and consider their jobs a better opportunity than would otherwise have been possible.
- Check the ownership, value and recoverability of collateral (equipment, vehicles, mortgage, gold jewelry, etc.) carefully. When repossession is necessary, do it in full daylight so that neighbors can see you are serious about repayment. Timing is important. For example, go to the house to repossess a television set during the World Cup match when motivation to make the payment is highest.
- Regional managers should make their visits to defaulters driving a pick-up truck because the threat is more real. Driving a car doesn't have the same effect because the defaulter knows you can't fit large items into your car.
- There is a benefit to having a non-Senegalese in the top management position. He or she can be more insulated from potential government attempts to influence operational programmatic decision making. This is much more a case by case judgement call than a hard and fast recommendation.
- Hire no one who has worked on another USAID or other donor's project. They expect a high level of per diem and perks which are not realistic.

- Don't hir people who have been functionaries with the government because they avoid responsibility and are accustomed to a non-demanding nine-to-five work schedule with long-term deadlines.

IV. REPUBLIC OF TOGO

FEDERATION DES UNIONS COOPERATIVES D'EPARGNE ET DE CREDIT DU TOGO (FUCEC)

1. ORGANIZATIONAL BACKGROUND

Organizational History

From a single village-level savings and credit cooperative to a national cooperative federation with more than 33,000 members, the cooperative movement in Togo has evolved dramatically in the more than twenty years of its existence.

The first Togolese cooperative was formed in southwest Togo in 1969 with the aid of an evangelical missionary. The cooperative was organized to help farmers escape the vicious cycle of borrowing and spending by mobilizing village savings and lending at a reasonable interest rate. The idea caught on, especially with coffee and cocoa farmers, and cooperatives were soon formed in other villages. Since 1969, cooperatives in Togo have gone through periods of stagnation and renovation, but the real take off point for the Togolese cooperative movement was the formation of the Federation des Unions Cooperatives d'Epargne et de Credit du Togo (FUCEC) in 1983.

FUCEC was founded to support, promote, and unify the Togolese cooperative movement. The World Council of Cooperatives and Credit Unions (WOCCU) agreed to provide technical assistance to support a long-term development program for FUCEC.

Funding for this program came from USAID through WOCCU. Additional technical assistance was provided by Credit Mutuelle de France and other donors.

FUCEC was organized to promote the creation and expansion of village-level savings and credit cooperatives (COOPECs), to promote solidarity and cooperation linkages, and to serve as a central credit facility for Togolese cooperatives. FUCEC was also designed to provide technical assistance and represent the cooperative movement to the government and international donors. From a total of 74 COOPECs, 6,595 cooperative members, and 206 million CFA ($824,000) in savings in 1983, there are now 145 COOPECs with 33,658 members and nearly 2.8 billion CFA ($11,200,000) in member savings.

Organizational Goals and Objectives

In the Togolese cooperative movement, cooperative membershipo is voluntary, savings required from members are not fixed, and interest rates on loans are affordable. The founding principles of the cooperative movement are:

- To affordably safeguard the security of members' savings.
- To offer an improved return on deposits.
- To increase the circulation of money and improve the financial potential of the region.
- To offer to the poor faster and easier access to credit.
- To offer more numerous and better adapted short term loans.
- To fight against usury.

- To mobilize the people in activities made possible by loans.
- To teach cooperative members the ideas of democratic self-management and progressive self-sufficiency.

2. PROGRAM AND SERVICE DELIVERY METHODS

Staff Recruitment, Hiring Criteria, and Practices

Finding competent job candidates has not been a major problem for FUCEC. However, selecting a candidate who is honest, has both academic and technical training, and shares the values of the cooperative movement has proved to be difficult.

An extensive screening process has been developed. A detailed job description, listing the required qualifications for the position, is advertised in local newspapers. Candidates take a written examination and those who do well are interviewed and evaluated by a 3 or 5 person hiring committee (the number of committee members is always odd to avoid ties).

Client Targeting, Selection Criteria And Screening

FUCEC's clients are its member cooperatives. Targeting, selection and screening for loans are all carried out at the local level by member cooperatives. They decide who may join the organization and the terms and conditions for borrowing from the cooperative.

Women are full members and active participants in Togolese cooperatives. At present, the elected president of two COOPECs and the head officer of the Central Liquidity Facility of FUCEC are women. Togolese women have a well established role in commerce and have traditionally dominated marketing at a village level. Women cooperative members have maintained the highest repayment records.

Loan Application Design and Implementation

FUCEC does not make individual loans; it lends only to member COOPECs which on-lend to individual cooperative members. To apply for a loan, a COOPEC must have been a member of FUCEC for at least six months and hold 25% of their deposits on account with FUCEC. They must also have a history of regular savings with FUCEC. COOPECs are allowed to borrow up to two times their level of savings with FUCEC.

In applying for a loan, a COOPEC must provide a list of its members who are asking for credit, the amount of their savings, and the amount they are asking to borrow. They must also provide FUCEC with a copy of their latest financial statement. The application is reviewed by the closest FUCEC regional delegate. Approved applications are forwarded to FUCEC headquarters, where the level of savings, arrears and defaults of the COOPEC are verified.

Provided there are no problems, the director of FUCEC approves disbursement of funds. If there are questions about the loan or the COOPEC involved, the application must be reviewed by the credit committee which is composed of members elected from

FUCEC's General Assembly. The credit committee usually meets three times a year in different locations throughout Togo.

Loan Portfolio Management Policies and Procedures

FUCEC's first priority in financial management is safeguarding the value of the COOPEC's deposits. To ensure that COOPECs have access to their deposits at all times FUCEC holds 15% of its equity in reserves. The basic concern of most individual COOPEC members is to have free access to their savings. COOPEC members are not worried about maintaining the value of their savings against inflation because inflation in Togo is relatively low.

FUCEC will not accept money from external donors for on-lending to its members. Donor money is used to help cover the costs of training and technical assistance, but all monies lent by FUCEC and its member cooperatives are internally generated. This policy is intended to foster a spirit of self-sufficiency because cooperative members may feel less of an obligation to pay back loan funds from an outside donor than from their own cooperative.

Non-Financial Program Service Delivery

FUCEC considers educating its members about the importance of savings and financial solidarity to be essential to the continued success of its lending program. It also believes in the importance of training. However, many cooperatives are unable to pay the full cost of training for their members and staff.

FUCEC formerly provided all training services free of charge, but it is now trying to increase its cost recovery. A sliding payment scale was introduced in 1988, based on a COOPEC's size, location, length of time in operation, and level of savings. Smaller and newer cooperatives (less than one year old) are allowed to send participants to FUCEC training sessions free of charge. Well established rural cooperatives pay 2,000 CFA ($8) per day per participant and urban cooperatives pay 3,000 CFA ($12). Through this system, FUCEC presently recovers 20-30% of the total cost of its training services.

FUCEC's training sessions are three to five days in duration and are held about four times a year, depending on the needs of member cooperatives. Training sessions are held in central locations and regional sites rotate from year to year. When trainees are required to stay over night, FUCEC will arrange lodging and provide an allowance for meals. The minimum number of trainees is 10 and the maximum is 30.

All COOPECs are expected to cover their operating costs (rent, electricity, water, etc.). FUCEC, however, has provided COOPECs with loans to construct an office and/or grants to pay the salaries of their manager and accountant until the cooperative can become financially self-sufficient. Construction loans range from 500,000 to 1 million CFA ($ 4,000) and are not intended to cover the full cost of the cooperative's building. FUCEC does not charge interest on these loans.

Grants for salaries are offered on a needs basis to smaller rural cooperatives. For example, a three year grant from FUCEC for a cooperative manager's salary could start out at 24,000 CFA the first year, decrease to 12,000 CFA the second year, 6,000 CFA

the third year and zero the fourth year. Of the 145 member cooperatives in Togo, only 15 have received either a grant or a loan.

Program Monitoring Procedures

One of the most important recent changes in the administrative system was the creation of an auditor's office at FUCEC headquarters in 1989. FUCEC's auditors make unannounced visits to member COOPECs several times a year. FUCEC's central cashier is audited once a month.

Board of Directors, Composition and Role

FUCEC has a board of directors elected from the representatives of it member cooperatives. As a democratically self-managed federation, the cooperative movement in Togo is organized on three levels: village or neighborhood cooperatives on the local level, cooperative unions on the regional level, and FUCEC on the national level.

A. Local Level Cooperatives

In rural areas COOPECs are organized on the village level, in urban areas they are organized by neighborhood or work place. Urban cooperatives are generally the largest and wealthiest. Local level cooperatives are organized along the following lines:

a. *Administrative Council-*

Composed of seven to nine people, the administrative council is elected by the COOPEC general assembly, which includes all active cooperative members.

The administrative council is headed by the cooperative president and is responsible for overseeing enforcement of cooperative rules, regulations and policies.

b. *Credit Committee-*

The three members of the credit committee receive and process loan applications according to policies established by FUCEC and by the local cooperative. The decision to lend or not is made by the credit committee according to the internal regulations of the individual cooperative.

c. *Surveillance Committee-*

The surveillance committee is made up of three members elected by the cooperative members to serve as the watchdogs of the cooperative. The surveillance committee assures that all rules and regulations are adhered to and that the decisions of the cooperative and of FUCEC are respected. The committee also assures that the cooperative's assets are protected and are managed properly through periodic audits.

d. *Manager-*

The manager's role in the cooperative is to maintain accounting and banking documents. Depending on the size of the membership, a cooperative can have from one to three managers working either part or full-time. Smaller rural cooperatives will often have one part-time volunteer manager, while larger cooperatives will employee up to three paid full-time managers.

B. Regional Cooperative Unions

Regional Cooperative Unions are organized by prefecture or a group of prefectures. Their role is to distribute information and promotional materials to the local cooperatives, organize regional cooperative meetings, and facilitate the choice of regional representatives to the FUCEC General Assembly. (Each regional union can send up to 5 representatives to the General Assembly.) There are a total of 11 Regional Unions.

C. General Assembly

This elected body represents all 145 Togolese cooperatives. Its role is to approve the accounts, the budget, and the annual work plans of FUCEC. Only the General Assembly has the power to change the internal regulations of FUCEC and to nominate cooperative members to elected office within FUCEC. In essence, FUCEC's board of directors is elected by the General Assembly of its member cooperatives.

3. FINANCIAL MANAGEMENT SYSTEMS AND PROCEDURES

Loan Fund Terms and Conditions

The Central Liquidity Facility at FUCEC headquarters was established as the financial clearinghouse of the Togolese cooperative movement. It lends only to cooperatives (COOPECs). COOPECs borrow money from FUCEC at an interest rate of 1% per month or 12% per year (the commercial interest rate is 19%), and on-lend this money to their members at a rate between 14% and 20% (depending on the policy of the

individual cooperative). FUCEC lends to its COOPEC members for a period of 24 to 36 months.

Before a COOPEC is eligible to borrow from FUCEC they must meet all the conditions prescribed below:

- be a member in good standing of FUCEC for at least 6 months;
- pay a 5,000 CFA loan application fee;
- purchase at least one share (50,000 CFA) of FUCEC stock;
- pay an annual fee of 1% of their savings (up to 200,000 CFA);
- hold at least 25% of their savings with FUCEC;
- complete a loan application form; and
- apply for up to 200% of their deposits with FUCEC.

The terms and conditions offered by COOPECs on loans to individual cooperative members are similar to those which FUCEC offers to the COOPECs. Loan terms and conditions vary somewhat from COOPEC to COOPEC because they are set by a vote of the cooperative's members.

The amount cooperative members may borrow is linked to the level of their savings. The interest rate on savings depends on the financial situation of the COOPEC but usually varies from 5% to 8%. All cooperative loans are short term, generally for a period of 12 months, but in exceptional cases for up to 36 months. COOPECs have approved loans for activities such as agriculture, animal husbandry, small enterprise development, equipment purchase, construction, educational expenses and health care costs.

As a precaution against default, all loans to cooperative members must have the double guarantee of the borrowers deposits in the cooperative plus the deposits of the member who sponsored their application the cooperative. (All new members must have a sponsor.) Although cooperatives rarely resort to the confiscation of sponsoring members deposits, the social pressure created by this guarantee is considered as a "secret weapon" to ensure loan repayment.

Loan Disbursement Procedures

After a loan from FUCEC to a COOPEC has been approved, the check must be signed by two officials from FUCEC and two members of the COOPEC requesting the loan. Usually these are the COOPEC president or treasurer and another COOPEC member. If the sum involved is large, or if the distance the COOPEC members must travel is long, a COOPEC may request that the money be transferred to a local bank in their region.

After receiving their check, the COOPEC must pay a 2,000 CFA opening fee. FUCEC is considering, but has not yet implemented, a sliding scale for opening fees, depending on the size of the loan. FUCEC does not directly involve itself in either the disbursement nor monitoring of loans after a check has been issued to the COOPEC. The COOPEC and its members are responsible for the funds, and for making loan payments on time.

Loan Repayment Collection Procedures

The repayment schedule for loans to an individual cooperative member from their COOPEC or to a COOPEC from FUCEC is negotiated on an individual basis depending on the reason for the loan and the business cycle of the borrower. Payments for urban commerce loans are usually due once a month, while payments for rural agricultural loans are often due once every six months at the end of the harvest cycle. COOPECs can also arrange a repayment schedule with FUCEC either once a month, three times a year, or once a year. According to the amount and type of loan, the loan term can range from 12 to 36 months.

Loan Arrearage and Default Practices

FUCEC relies on social pressure, backed by financial pressure on the borrowers savings, and the threat of legal action to recover its loans. According to FUCEC policy, loan payments which are late by more than a month are delinquent. Presently just over 21% of all loans are in arrears and 16% are in default.

When arrears do occur, it is the responsibility of cooperative management to ensure they are dealt with quickly. The first recourse of the cooperative manager is to create social pressure on the borrower through the cooperative's General Assembly. If social pressure from the borrower's peers is not sufficient, a second approach is to work through the village chief.

If the borrower does not respond to social pressure, the cooperative can seize their savings to cover the cost of the loan. (Cooperative members are required to have saved 50% of the value of their loan with the cooperative.) As further recourse, the

cooperative can seize the savings of the cooperative member who sponsored (and therefore guaranteed) the borrower. As a last resort, the cooperative can go to the local police and have the borrower arrested.

Past high levels of arrears are a source of concern for FUCEC management. However, progress has been made in identifying and reducing arrears over the last four years. Unknown arrears have declined from more than 75% in 1988 to 0 in 1992. FUCEC attributes this to several factors: improved computerized and manual accounting systems, a training program to help COOPEC managers better classify and monitor loans, and increased enthusiasm and professionalism at the grassroots level. Under this new program, each COOPEC evaluates its arrears every month and reports to FUCEC every three months on their level of arrears.

Until 1990, COOPECs in Togo had relatively few loan defaults. A 50% decline in coffee and cocoa prices in 1990 caused a sudden jump in default rates. In 1990, defaults on agricultural loans reached 25%. The default rate for 1992 is currently 16%. Individual cooperative members have defaulted on loans from their COOPEC, but no COOPEC has ever defaulted on a FUCEC loan.

Loan Program Accounting Procedures

FUCEC uses a combination of sophisticated computerized and manual accounting procedures to track its loan portfolio. A computerized accounting system called InfoCOOPEC was recently designed for FUCEC. InfoCOOPEC took two years to develop and is presently being tested in two village COOPECs, one urban COOPEC, and

at FUCEC headquarters. After field testing the system, FUCEC will develop an appropriate plan for expanding its use to local-level cooperatives.

Role of Commercial Banks

Because FUCEC's member cooperatives lend to individuals who would not normally be able to borrow from banks, FUCEC regards its relationship with commercial banks as complementary rather than competitive. FUCEC has diversified its accounts among several banks in Lome. FUCEC would like to, but is not at present allowed to, borrow from and invest in the Togolese central bank.

4. INSTITUTIONAL DEVELOPMENT ISSUES

FUCEC enjoys a very good reputation as an umbrella organization, responding well to the organizational development needs of its member credit unions whose total assets and geographical coverage area have been steadily expanding.

The government of Togo has not interfered significantly with FUCEC's day-to-day operations and has allowed FUCEC to develop its own organizational systems and character. However, FUCEC has encountered difficulties due to the lack of a legal framework for credit unions and management is currently trying to convince the government to amend its 1967 law governing the operation of cooperatives. FUCEC seeks to get specific protection for credit union savings and loan operations and to gain access to available "soft loan" opportunities.

Problems, Constraints and Challenges

- Although the lack of a specific law governing credit unions has allowed FUCEC to evolve independently as an organization, it has, among other things, left FUCEC without any legal recourse for protecting the name FUCEC. FUCEC has from time to time had to deal with swindlers who falsely claim to represent a cooperative and who attempt to steal money from villagers or credit unions members. This type of misrepresentation is not widespread, but FUCEC is concerned because the dishonest activities could harm their credibility with actual and potential client organizations.
- FUCEC management describes the biggest challenge faced by the cooperative movement in Togo as that of building confidence among villagers to trust the cooperative and each other. Building a cooperative consciousness and a willingness to pool savings with others has proven difficult on the village level. It requires not only overcoming fear among villagers of letting their neighbor know how much money they have, but also the fear of what their neighbor will do with the money if they have control of it.
- Confidence in banks decreased sharply following the collapse of the government controlled Agriculture Bank (Caisse Nationale de Credit Agricole, CNCA) in 1987. The Government of Togo (GOT) made several unsuccessful attempts to get international donors to provide funds to revive CNCA.
- GOT previously operated parastatal marketing cooperatives which were reportedly run badly and lost money. As the sole legal purchaser for coffee and cocoa,

these parastatal cooperatives would buy cheap from Togolese farmers and sell dear on the international market. Although these parastatals had very little to do with true cooperatives, their bad example created a certain amount of mistrust among Togolese farmers of any sort of cooperative.

- Some unsuccessful NGO credit operations have diminished Togolese confidence in the reliability and sustainability of loan programs. The demise of a Partnership for Productivity (PfP) program was reportedly caused by low repayment rates and high administrative costs. Similarly, FUCEC reports that a CARE/Togo project offered short term no interest group loans for farming inputs and expected that peer pressure would encourage repayment. There was little or no follow-up by CARE/Togo, and most of the loan groups disbanded following the harvest without repaying their loans. Both of these credit programs have now been discontinued, but FUCEC feels that these negative experience gave some Togolese farmers the impression that loan repayment was arbitrary.
- FUCEC and the credit unions it serves have no competition from commercial banks in serving "grassroots" areas in Togo, however, they do have competition they from tontines (informal rotating savings and credit groups), principally in the Southeastern section of the country.

  Some tontine organizers have even discouraged their members from investing their money with "outsiders" from FUCEC. Tontine organizers argue that credit unions are "too formal" because they lack the socializing offered by periodic tontine parties and celebrations held for their members. Despite these social

benefits, some villagers in areas where tontines are still dominant have asked to join cooperatives because they regard cooperatives as more reliable and accountable than tontines. FUCEC does not actively compete with tontines in the Southeast and has pursued a strategy of peaceful co-existence with them. Elsewhere in Togo, tontines do not present a problem for FUCEC.

- FUCEC recognizes that it has a cost-recovery problem because at present, only 20 to 30% of its training costs are being covered by fees for services. This is the result of a conscious administrative decision to provide training as a means of organizational development and gradually phase in higher fees based on ability to pay. To help deal with this, FUCEC has developed a five year program to move from 30% to 70% financial self-sufficiency.
- FUCEC's arrearage level increased considerably with the dramatic drop in coffee and cocoa prices in 1990, but FUCEC management is actively seeking to bring down the level of arrears. Arrears are still a problem for FUCEC, but the situation seems to be improving as loans are rescheduled.

Significant Accomplishments

- FUCEC's management has expressed pride in its ability to build its member credit union's assets on deposit to the current level of some three billion CFA (over $11 million U.S. dollars). FUCEC also expressed pride in the steady growth of its membership. Between May and September of 1992 FUCEC's

membership increased from 28,000 to 36,000 members. This positive growth trend has continued as FUCEC expands into new regions.

- FUCEC's management takes pride in its institution-building efforts which have created a feeling of ownership and commitment among member credit unions. This is expressed as "a sense of affinity and ownership". FUCEC reports that "people value credit unions because of what they do for them."
- FUCEC lends only the Togolese savings of its member credit unions rather than seeking outside funding to capitalize its loan fund. They explain that members treat their own money more respectfully than outside money which does not carry the same peer pressure for repayment.
- FUCEC is able to identify delinquent accounts at individual credit unions every month, rather than waiting for quarterly reports. In 1988, FUCEC had significant problems identifying when a loan was made, for what purpose and the reason payments were delayed. At the end of 1988, level of unknown delinquencies was approximately 500 million out of 750 million total amount loaned. By December 1991, the amount of unknown arrears was negligible on a total of 1,842,000,000 CFA loaned.
- FUCEC is proud of the high level of support its bookkeeping training programs are receiving at the village level. When FUCEC gives bookkeeping seminars in villages, trainees stay after the training sessions are over and want to learn more about "what we can do to help people".

Lessons Learned and Recommendations

- Decentralize the administrative function rather than have it focused exclusively at the headquarters level and delegate authority not just responsibility. FUCEC functions well, even when the manager is not around, because everyone is clear about their individual roles and responsibilities.
- Computers are useful, but hiring a competent, honest and hard-working staff is more important. "Computers don't work, people work." At the staff level what matters most is technical skills, which can be learned or upgraded, and personal honesty.
- At the grassroots level, what matters most is that the member's savings are safe and the local credit union is organizationally sound. The risk of too much growth causing managerial over-extension is not a problem, as long as FUCEC's member credit unions remain strong.
- FUCEC subsidizes most of the costs of the training it provides to member credit unions. Promotion and auditing services are also provided free of cost. FUCEC is aware of its need to become more financially self-sufficient and is gradually phasing in more fees.
- FUCEC sees itself as deeply committed to a process of institutional growth and development. "Grassroots people must learn to identify and cope effectively with their own problems at the local level."

- Remain a single purpose organization. Don't diversify and thereby divide your attention and energy so that grassroots institutional development suffers as a result. Grow slowly and at a sustainable pace.
- Organizational growth should be seen in terms of the percentage of the total population active in the credit union movement. Growth should not be measured exclusively in terms of the total number of credit unions.
- Nobody should be allowed to go free without paying their debts. This sets a dangerous precedent and erodes FUCEC's credibility.
- Follow the basic rules of the credit union movement. Lend only to members and only up to twice the savings they have on deposit. Require co-signers.
- Invest conservatively to preserve the savings of your member credit unions. For example, buy monthly certificates of deposit from solid commercial banks. Do not make speculative investments and take chances with people's savings.
- Resist legislation restricting the operations of credit unions. They are private enterprises capable of self-regulation.
- Build up your cash reserves. FUCEC recommends a ratio of 15% equity capital to total balance sheet assets. This is almost twice the 8% ration maintained by some banks.
- Recruit a higher level staff capable of learning the technical skills they need to know. They must be able to understand what supervisors mean when they talk to them, rather than requiring repeated explanations.

- Administrative staff members must be able to understand and interpret the information displayed on the computers. They must know how the interest calculations are done and understand how data is gathered and why it is important that it be accurate. Blind reliance on computer software without adequate background knowledge is not sufficient for making informed management decisions.
- Always be sure that power, responsibility and authority for local credit union decision-making is focused at the grassroots level. Grassroots solidarity is the cohesive force. FUCEC's role is advisory and must remain responsive.
- Whether your operation is fully computerized is not the key concern. What matters is that you are receiving accurate, up to date information on loan performance so that problems can quickly be identified and remedied.