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ABSTRACT

Maximizing the Outreach of Microenterprise Finance:
The Emerging Lessons of Successful Programs

by

Robert Peck Christen, Elisabeth Rhyne, and Robert C. Vogel

January 1995

This report examines eleven programs that deliver financial services to microenterprises, with the intent of learning from top-performing institutions. It examines performance from two perspectives: (1) outreach--the ability to reach large numbers of people, and exspecially the very poor, with quality financial services; and (2) financial viability--the ability to operate at a level of profitability that allows sustained service delivery with minimum or no dependence on donor inputs. Outreach is examined along three dimensions: quality of service, level of poverty, and scale. Viability is assessed in terms of levels of financial self-sufficiency and leverage.

Key findings are that:

- microenterprise finance institutions can achieve strong outreach in terms of depth (reaching the very poor), extent (significant scale), and service quality;
- operational efficiency can be achieved consistently in microenterprise finance, in a range of settings, and with a variety of clientele;
- it is not yet conclusive that full profitability can be consistently achieved in all countries; however, the rapid progress in the field suggests than in a few years the ranks of the self-sufficient programs will be significantly larger;
- two variables were significant in determining profitability: higher real interest rates and lower average salary compared with per capita GDP, both within the control of program managers;
- factors not directly correlated with financial viability included loan size, geographic setting, and economic setting; and
- shortcomings of the microenterprise institutions studied were the absence of savings services and the lack of adequate financial and outreach information.

The assessment suggests that donors pay close attention to the following issues in designing microenterprise finance programs: operational efficiency, interest rate policy, and performance reporting standards. Donors can also help top-performing institutions make the transition to independence through policy dialogue in areas such as establishing supervisory standards, developing savings services, and securing equity investors.

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Maximizing the Outreach of Microenterprise Finance: The Emerging Lessons of Successful Programs

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MAXIMIZING THE OUTREACH OF MICROENTERPRISE FINANCE:

THE EMERGING LESSONS OF SUCCESSFUL PROGRAMS

SEPTEMBER 1994

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GLOSSARY OF ACRONYMS

ACEP	Agence de Crédit pour l'Entreprise Privée (Dakar, Senegal)
ADOPEM	La Associación Dominicana pare el Desarrollo de la Mujer (Dominican Republic)
BancoSol	Banco Solidario (La Paz, Bolivia)
BKD	The Badan Kredit Desa (Indonesia)
BRI	Bank Rakyat Indonesia
BRK	Bankin Raya Karkara (Maradi, Niger)
CAMEL	Capital Adequacy, Asset Quality, Management, Earnings and Liquidity
CDIE	Center for Development Information and Evaluation
FINCA	Fundación Integral Campesina (Costa Rica)
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
GNP	Gross National Product
K-REP	Kenya Rural Enterprise Programme (Nairobi, Kenya)
LPD	The Lembaga Perkreditan Desas (Indonesia)
NGO	Non-Governmental Organization
PRODEM	Fundación Prodem
PVO	Private Voluntary Organization
USAID	U.S. Agency for International Development

EXECUTIVE SUMMARY

This study examines eleven programs that deliver financial services to microenterprises, with the intent of learning from top-performing institutions. It takes place in the context of an increased emphasis in USAID on microenterprise development, and is intended to update USAID's knowledge of this field and to contribute to USAID programming guidelines. The study examines programs commonly thought to be among the best microenterprise finance programs in the world, though the sample was also drawn to ensure a range of geographical setting, institutional type, and level of clientele. Programs were included from Indonesia, Bangladesh, Kenya, Senegal, Niger, Costa Rica, Colombia, the Dominican Republic, and Bolivia.

The study assesses performance of these programs from two perspectives: *outreach*, that is, the ability to reach large numbers of people, and especially the very poor, with quality financial services; and *financial viability*, that is, the ability to operate at a level of profitability that allows sustained service delivery with minimum or no dependence on donor inputs. The study is mindful of the scarcity of donor resources relative to the vast potential market for quality financial services among the poor throughout developing countries. It therefore emphasizes the search for ways to leverage donor inputs to the maximum extent possible.

Background

Expanding access by the poor to financial services is a goal that has frustrated development practitioners for decades. The distressing legacy of subsidized directed credit has created many skeptics. Most directed credit programs targeting small farmers and other priority groups have failed. They have not been financially self-sufficient, they have not reached the poor, and they have distorted financial markets.

Recent performance among "frontier" microfinance programs, such as those examined here, demonstrates that some managers have learned from the mistakes of subsidized directed credit efforts. Building on a new body of techniques for working with poor clients (such as group lending), programs are finding it possible to achieve substantial cost recovery, and are accordingly paying greater attention to financial performance. Increasing numbers of institutions have crossed major hurdles in terms of outreach, raising resources on commercial markets, and increased service to difficult-to-reach populations. This study examines how far such institutions have come along the outreach and financial viability dimensions, and outlines some of the major challenges facing programs as they try to move still farther.

Study Approach

The eleven microenterprise finance programs included in the study were selected according to several criteria, such as loan size (a rough proxy for client income level), number of borrowers, and reputation for financial strength. There was a special effort to select at least one institution that focuses exclusively on the very poor in each of the three major geographical regions. Programs examined were: the Unit Desa System of the Bank Rakyat Indonesia (BRI), Lembagan Perkreditan Desas (LPDs) of Indonesia, Badan Kredit Des (BKD) of Indonesia, Las Associacion Dominicana para el Desarrollo de la Mujer (ADOPEM) of the Dominican Republic, Actuar Bogota of Colombia (whose name has recently changed to Corposol), Fundacion Integral Campesina (FINCA) of Costa Rica, Banco Solidario, S.A. (BancoSol) of Bolivia, Kenya Rural Enterprise Programme (K-REP), Agence de Credit pour l'Enterprises Privee (ACEP) of Senegal, Bankin Raya Karara (BRK) of CARE in Niger, and Grameen Bank of Bangladesh.

The study gathered data on a consistent basis about outreach and financial performance for each program over a five year period. Most data was gathered through visits to the programs. In some cases analysis was based on prior visits and public sources. Given the scarcity of data available on outreach, the study focused on numbers of clients, growth trends in clientele, loan size, and the percentage of women clients as they main outreach indicators. On the financial side, the study adjusted financial statements from each program to place them on a comparable footing (accounting for differences in definitions of such concepts as arrears) and to remove the influence of subsidies from key indicators of profitability. Thus, each program was viewed as if it operated on a fully commercial basis, applying private sector standards for financial viability.

Findings

Outreach to the Poor

The microenterprise finance institutions examine here demonstrated that significant outreach to the poor, including the very poor, can be achieved. Clients of these institutions operate were very small and would otherwise be excluded from formal financial services. Most programs (six of eleven) cluster in the range of $200 to $400 average loan size, reflecting that financial services were reaching the very poor. The range of average loan sizes was from $38 to $1,016. Also, these institutions reach large numbers of women, either by design or by virtue of the market they serve. Programs offering smaller loans tended to serve more women.

Several institutions examined, notably those in Indonesia and Bangladesh, have already achieved extremely high coverage on a national scale. Grameen Bank's market outreach covers almost half the villages in Bangladesh, reaching nearly 2 million very poor clients. In Indonesia, the BRI Unit Desas also have nearly 2 million borrowers, and also serve 12 million savers. The BKD system covers 20 percent of the villages in East Java. In Bolivia, BancoSol has reached nearly 50,000 borrowers, covering an estimated 10 percent of the potential market. Most other programs are growing at such a rapid rate, averaging between 25 and 100 percent annually in terms of clients, total assets, and loans disbursed, that others will soon be nationally important.

The programs offer primarily short term working capital loans. They use groups, social pressure and the promise of continued access to increasing amounts of credit to motivate repayment. Turnaround time for loans is significantly less than two weeks at most institutions, and services are available close to borrowers' home or work. These elements appear to be attractive to clients. The dramatic annual growth in the number of borrowers, loan portfolio, and, in some programs, savings deposits, is evidence of strong client response to the services. Also, clients are willing to pay interest rates significantly above the rate of inflation, and to repay loans on a timely basis, as evidenced by low delinquency measures.

The study demonstrates that among high-performing programs there is no clear trade off between reaching the very poor and reaching large numbers of people. In fact, mixed programs which serve a range of clients, not exclusively the poorest, such as BancoSol and BRI have successfully reached very poor clients, and the achievement of significant scale by such programs means that substantial numbers of the very poor are being served. In short, it is scale, not exclusive focus, that determines whether significant outreach to the poorest will occur.

Financial Viability

Ten of the eleven institutions examined were *operationally self-sufficient*. They fully covered the non-financial costs of operations (salaries and other administrative costs) with program revenues (interest and fees). The programs achieved these goals in a variety of settings, ranging from rural Bangladesh to urban Bolivia, and with a range of clientele. The conclusion is that it is consistently possible for competent institutions microfinance programs to achieve operational self-sufficiency within a reasonable time frame. This finding sets clear expectations for microfinance programming.

Five of the eleven institutions were *fully self-sufficient, or profitable*, generating positive inflation-adjusted returns on assets. Program revenues covered both the non-financial costs as well as the financial costs of obtaining loanable funds on a commercial basis. No longer do these programs rely on concessional funding or other subsidies to cover their costs. Fully self-sufficient programs charged an effective real rate of interest high enough to cover all costs, including potential devaluation due to inflation.

These findings demonstrate that financial services to the poor can be provided on a financially viable basis. However, with only five of the eleven institutions examined crossing the threshold of full self-sufficiency, it remains an open question whether full self-sufficiency is consistently possible in a variety of settings. Still, the rapid progress of many institutions suggests that the number of profitable microfinance institutions will increase during the next few years.

Keys to Financial Viability

The study sought to explain why some programs examined were more financially viable than others. It looked first at loan size, to see whether programs with larger loans were more viable. This did not prove to be the case. Nor did traditional measures of productivity, such as numbers of clients per staff, explain differences in financial results. Similarly, the local policy environment (GDP growth, financial sector repression, and macroeconomic stability) did not appear to determine success. Only two factors were important in explaining differences: salary levels relative to local GDP and the effective real rate of interest (i.e., relative to inflation).

The surprising lack of importance of loan size and productivity measures can be understood by noting that the programs were selected on the basis of their success. In each case, the programs had already adjusted methodologies and cost structures to fit their local context, and had achieved efficiency in operations, as reflected in operating costs of between 10 and 20 percent of loans outstanding. Rather, differences in financial viability were largely a factor of the level of commitment of the institution to reaching that goal, and the reflection of that commitment in the choice of interest rates and salary structures. For example, K-REP, with the lowest return on assets was just as efficient in operational terms as Actuar Bogota, with a very attractive return on assets. The difference is that K-REP charges a substantially negative real rate of interest, while Actuar's interest rate is substantially positive in real terms. The conclusion is that once an institution has developed a successful methodology and a good working relationship to its clients, achievement of financial viability depends on commitment and policy choices.

It was particularly noteworthy that successful microfinance programs were found in a wide range of policy environments, even including significant inflation However, none of the

successful programs were found in hyperinflationary settings. It appears that stable macroeconomic conditions and low inflation do support the growth of microfinance institutions, but that these institutions can also cope with relatively unfavorable conditions.

Implications for Donors

The achievement of successful microfinance programs suggest that donors should make the effort to bring the full potential of microenterprise finance to fruition. Such programs offer good prospects of making substantial contributions to the demand for financial services among the poor. However, achievement of such potential requires strategic action, in keeping with the limited resources that donors can bring to bear on this issue.

First, donors should use the examples of the successful institutions in setting expectations for achievement by other institutions it funds. Operational self-sufficiency should be considered a minimum goal, achievable by all institutions within a reasonable time frame, even those aimed at the very poor.

Second, donors should craft their support in ways that foster financial independence. They should particularly support the transformation of institutions from grant-and-concessional-loan funding to commercial-and-depositor funding. Programs that become full-fledged financial intermediaries offer by far the greatest prospects for obtaining high leverage from scarce donor resources. Nationally relevant scale will generally not be met without substantial leverage.

Several specific areas of focus that emerge from the study are:

- Interest rate policy. Donors should insist that organizations they support price their services at a level that supports financial viability.

- Reporting standards. Donors should insist that supported organizations report on their performance according to generally accepted standards. Such information is crucial both for internal management of programs and for winning the confidence of commercial funders.

- Frontier issues. Donors should offer targeted assistance to help top-performing institutions make the transition to full independence, in areas such as supervisory standards for microfinance, techniques for managing deposits, and support to the process of securing equity investors.

CHAPTER I. CONCEPTUAL FRAMEWORK: OUTREACH AND FINANCIAL VIABILITY

Introduction: The Setting for the Assessment

Throughout the developing world, millions of low-income people pursuing entrepreneurial activities are largely ignored by the formal sector. They lack access to the services that would enable them to participate fully in the economic life of a country. Among the most important services are savings and credit -- financial services.

The field of microenterprise finance has been developing rapidly during the late 1980s and early 1990s as a way to bring good financial services to the poor, and thereby to help them build stronger enterprises, and ultimately to better their incomes and quality of life. Progress in the microenterprise finance field has been significant during these years. As donors, governments and practitioners learn more about how to provide financial services to the poor, increasing numbers of institutions are entering the field, and leading institutions are expanding the frontiers. The parameters that set expectations about microenterprise finance in the mid-1980s are no longer valid, as more institutions cross major hurdles in terms of scale of outreach, ability to raise resources on commercial markets, and increased service to difficult-to-reach populations.

USAID has made a significant commitment to continue and expand its microenterprise program, as expressed in the Microenterprise Charter, signed in June 1994 by the Administrator and several members of Congress. However, the Center for Development Information and Evaluation's (CDIE's) last major look at microenterprise development took place in the 1989 Stocktaking exercise when many of the changes just noted were only starting to get underway (Boomgard, 1989).

The purpose of this assessment is to examine programs widely perceived to be on the frontier of microenterprise finance so that recent advances in the field may be incorporated into USAID policy guidance and programming. Unlike the Stocktaking Report, this is not an evaluation of the state of microenterprise programs as a whole. Rather, it is an examination of best practices, intended to provide a basis for setting performance standards and defining assistance strategies.[1]

The Optics: Outreach and Viability

This study examines the performance of microenterprise finance programs through the optic of two central concepts, outreach and financial sustainability. Outreach is a shorthand for the basic purpose of microenterprise finance -- to provide large numbers of poor people (including the very poor and women) access to quality financial services. Financial sustainability refers to the creation of institutions that become independent of continuing subsidies from governments, international agencies or charitable organizations. Both these concepts are important organizing principles for participants in the microenterprise finance field.

A growing literature on microenterprise finance has noted recent gains in outreach and financial viability among certain well-performing institutions.[2] For example, individuals associated with

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[1] A companion study, Buttari, 1994, reviews the literature on and experiences with traditional directed credit approaches to reaching the poor with financial services.

[2] See, for example, Krahnen and Schmidt (1994), and Otero and Rhyne, eds. (1994).

the experience of the Bank Rakyat Indonesia (BRI) have long asserted that BRI has demonstrated both outreach and financial viability.[3] The present study examines whether strong performance along both dimensions applies broadly across institutions in a variety of settings. Despite the growing number of studies on individual institutions, the type of analysis carried out here, i.e., comparative analysis of actual program and financial results, has rarely been carried out. One study to have done so, Yaron's comparison of four apparently successful financial institutions, is an important precursor to this study (Yaron, 1992a). In fact, the focus on outreach and self-sufficiency is taken from the framework articulated in that study.

The present study examines eleven microenterprise finance institutions generally perceived to be successful. (See Box 1.) These institutions operate in a range of geographical, cultural, and economic settings, and use a variety of methodologies. However, all are focused primarily on the provision of credit and savings services to previously excluded groups, and all have achieved some measure of success, as defined by numbers of clients served and financial performance.

Analysis of these institutions allows us to explore some of the most important questions confronting the microenterprise finance field:

- How are outreach and financial viability related? Does serving the poor preclude achievement of financial self-sufficiency? Or, as in the case of BRI, can institutions achieve both?

- How financially viable can microenterprise finance institutions be? Can they reach commercial standards? consistently, or only in limited settings?

- If we wish to ensure that microenterprise finance reaches even the very poor, must we expect to support institutions that cannot become financially independent of donor subsidies?

- What factors are necessary for the achievement of strong outreach and financial viability?

- What are the challenges facing frontier institutions, as well as the challenges facing institutions that have not yet reached the frontier?

In addition, this paper explores the general settings in which these programs operate, seeking to draw conclusions about the relationship between successful microenterprise finance experiences and the local policy environment.

The remainder of this chapter defines outreach and financial viability in greater detail. It lays out what is meant by reaching the poor in substantial numbers and provides a framework for viewing the value and quality of financial services. It defines various standards of financial viability, and describes why donors and implementors should be concerned with reaching viability.

[3] Patten and Rosengard (1991), Robinson (1992a, 1992b, and 1994).

The discussion of these questions provided in Chapter I constitutes the conceptual framework for the study. After this framework is established, there is a brief description of the methodology used to select and examine the institutions. Chapter II discusses the results obtained from reviewing successful institutions, and Chapter III points to future challenges for the microenterprise finance field. Finally, Chapter IV briefly summarizes the main findings and indicates some of their implications for donors.

I.A. Defining Outreach: Reaching Substantial Numbers of the Poor

In this study, outreach is examined along three dimensions: quality of service, level of poverty, and scale. The framework used in this study requires some success along all three dimensions for an institution to be considered to have good outreach. Assessment of successful outreach involves a look at whether an institution serves poor or disadvantaged groups, whether it reaches a significant number of such people, and whether it provides quality financial services. Because these three dimensions are so different, it is not easy to put outreach into a single numerical index. A qualitative picture must suffice. Before discussing these three dimensions more fully, the paper turns to definition of the populations microenterprise finance institutions serve.

I.A.i. The Boundaries of Inclusion

In most developing countries, most of the population lacks access to formal financial services. The scope for extending access encompasses a wide variety of people, enterprises, and activities. Although the field of microenterprise finance has traditionally selected a somewhat narrower range of focus, its range is broadening and becoming, simply, "microfinance."

As the term microenterprise finance is generally used, it centers on poor people with enterprises of their own, including the self-employed. This definition has included start-up enterprises, even at the smallest level, as well as seasonal or part time income-generating activities. Microenterprise finance has tended to exclude small farmers, who have been the target of agricultural credit programs, and it has excluded households, except as they are linked to enterprises. There has also been a cut-off in size of enterprise, often using a reference point of five or ten employees to distinguish microenterprise from small business. The term poverty lending has emerged as a subset of microenterprise finance, denoting credit to the very poor, including those who had not previously carried out income-generating activities.

There are strong indications that building financial services around a target of poor people operating enterprises may offer greater promise of financial viability for those services than centering on other types of populations, even where there is substantial overlap (e.g., small farmers or small exporters), largely because the risks involved in lending to microenterprise are somewhat easier to diversify than the risks of, for example, agricultural lending. Patten and Rosengard (1991, Chapter 2) discuss how the shift in definition of the target population from small farmers to microenterprises allowed for the successful development of rural financial institutions in Indonesia.

BOX 1. The Institutions Analyzed in this Study: Institutional Type and Relationship to USAID.

ACEP in Senegal, is an NGO which grew out of a USAID-funded project. Starting in a provincial town, it now also operates in urban settings. ACEP is in the process of becoming a credit union in order to be able to raise funds through depositors.

Actuar Bogota, or more recently, *CorpoSol*, is an NGO affiliated with ACCION International, and operating in the greater Bogota, Colombia area. It has recently opened a finance company, which will allow its transformation into a financial intermediary.

ADOPEM, in the Dominican Republic, an affiliate of Women's World Banking, is an NGO serving exclusively female entrepreneurs. USAID has supported ADOPEM for the past several years through a microfinance wholesaler, FONDOMICRO. ADOPEM also obtains loans from local commercial banks.

Banco Solidario, S.A. (BancoSol) in Bolivia, is a licensed commercial bank devoted solely to microenterprise, and operating in major cities throughout the country. BancoSol grew out of PRODEM, an NGO affiliated with ACCION International, which received major start-up financing from USAID.

Bank Rakyat Indonesia (BRI) is a government-owned bank oriented toward rural areas. BRI's Unit Desa System, an extensive network of small profit centers, is the portion of the institution analyzed here. USAID provided extensive technical support to BRI in transforming the Unit Desa System into its current form.

The *BKD* System in Indonesia is a system of small banks in towns throughout Indonesia, which emerged during the Dutch colonial period. The banks have been gradually modernized, though they have received little external assistance in recent times.

The *BRK* in Maradi, Niger, is a relatively young program operated by CARE. Begun in 1991 with USAID funding, it quickly surpassed expectations regarding outreach across the country, in sparsely populated areas, in a country where widespread lending would appear to be difficult to achieve.

FINCA/Costa Rica is one of the earliest programs using the village banking methodology FINCA developed. It differs from newer FINCA programs in that it serves both men and women, makes somewhat larger loans, and is focused on agriculture.

Grameen Bank in Bangladesh is probably the best-known microfinance institution in the world, begun as an experimental project in 1976 and given a special banking charter in 1983. It serves mainly women, and operates throughout rural Bangladesh. Grameen Bank has received funds from many donor organizations, but not, until very recently, from USAID.

Kenya Rural Enterprise Programme (K-REP) is a local NGO which works in both rural and urban Kenya. K-REP began as a USAID project in 1983, and has since become an independent Kenyan organization. It adopted its current methodology, analyzed here, in 1990.

LPD in Bali, Indonesia, is a network of village-owned institutions supervised by the provincial government of Bali. The LPD system has received extensive technical support from USAID to improve its staff training, operational methods, and information management.

However, as microenterprise finance has grown, its boundaries have begun to widen. Successful institutions have tended to expand their services to increasing portions of those lacking access to quality financial services, building on the core of financial services to enterprises. This expansion takes three main directions. Most importantly, institutions offering voluntary savings services can aim to include most households in the geographic area they serve as deposit clients, even households that do not operate enterprises. Secondly, institutions in rural areas have begun to include loans for livestock and crop cultivation. Thirdly, some institutions have added small business lending so that they can continue to serve their most successful clients who have grown significantly. Microenterprise finance institutions may be able to broaden services at a low marginal cost building on their substantial investment in reaching out to the poor. Thus, as microenterprise finance matures, it pushes into a broader spectrum of the population. It goes beyond microenterprise finance to become, simply, microfinance.

The institutions reviewed here are microenterprise finance institutions in the traditional sense, serving primarily poor people who operate, or who are starting to operate, very small enterprises. At the same time, several of these institutions are adding services to become broader microfinance institutions.

I.A.ii. Reaching Them with What? The Value of Financial Services

Microenterprise finance matters because access to credit and savings services matter in the economic circumstances and quality of life of poor people. Such services can enable microentrepreneurs to increase the already substantial contributions they make to the economy. Increasing quality of life and economic contributions through greater outreach are the driving motivations behind this study, as well as behind the field of microenterprise finance generally. A complete understanding of outreach therefore requires an explanation of how financial services can make a difference.

Financial services help people meet their household and business goals. Despite the apparent simplicity of their activities, microentrepreneurs and self-employed people make a complex, ongoing series of financial decisions and must be sophisticated managers of their financial affairs. Among the many decisions they make are: how to allocate income from a business between household and business expenses; how much to save, when, and in what form; how much and when to invest and in what; how to balance between short-term consumption and long-term goals; how to protect themselves against the many risks they face; and how to position themselves to take advantage of business opportunities.

These are crucial decisions, and they are more likely to lead to success if supported by access to good financial services. Without access to financial services, individuals face a more limited array of options. Access to financial services gives people the ability to expand their options and thereby to increase the productivity of their resources. Savings services allow depositors to store current income as assets for future use, while credit services allow clients to invest or consume now, drawing on expected future income.

The use of financial services as an ongoing process has been explored from the point of view of household risk management. Townsend and Rashid focus on finance as enabling "consumption

smoothing" over time as people attempt to hedge themselves against periods of inadequate income. Consumption-smoothing has welfare-enhancing effects because it means that people are less likely to suffer when inevitable external shocks hit them (drought, illness, etc). Some researchers have also shown that efficient forms of risk protection can free people to make higher return investments. In a study of poor farmers in India, Binswanger and Rosensweig showed that, when risk was mitigated, the farmers were able to make higher return investments.

These observations show why financial services are important. In short, one cares about access by microenterprises and poor households to financial services because such services give people an important tool for improving their efficiency, productivity, and welfare while reducing risk.

Informal financial services are widely available in developing countries. Such services have the advantage of being appropriate to the local context, and many have characteristics that make them useful to poor clients (see Adams and Fitchett, 1992). Informal financial systems often have significant limitations, however, such as limited ability to diversify risk or limited ability to raise funds for on-lending (see Robinson, 1992a). Microfinance programs make sense relative to informal finance when they are able to offer better services at lower cost (including both monetary and transaction costs).

The foregoing observations about the financial management tasks of microentrepreneurs define the characteristics of good financial services, and hence what the study seeks in assessing service quality provided by microfinance programs. First, financial services should include not only credit but also savings services. One important current trend in microenterprise finance is increasing recognition of the importance of savings services for clients. Savings enable people to prepare for contingencies in advance. Savings services provide exactly the kinds of flexibility to respond to circumstances that the financial management process requires. Savings can perform many of the same functions as credit, as both a short-term source of liquidity and a long-term reserve for emergencies (Gadway et al., 1991). It should also be noted that in order for savings to perform these functions well, savers must have access to their funds whenever contingencies arise. Therefore, it is important for savings services to feature liquidity. Typically, compulsory savings requirements included as part of microenterprise credit programs fall short in this respect.

Second, if financial management is a continuing process, financial services should be available on an ongoing basis. One-time injections of funds do not provide the continuing liquidity needed for microenterprises operations. Some observers have even shown that enhanced liquidity management opportunities can increase the productivity of the fixed capital used by microenterprises.[4] Liquidity management requires having funds readily available. Thus, liquidity, convenience, and ongoing availability are characteristics this study will look for in assessing outreach.

Finally, supportive financial services allow for the fact that microentrepreneurs have a variety of uses of funds, including not only the activity for which a loan is formally given, but also for household operations and other family enterprises. Thus, quality financial services are given

[4]Vogel and Burkett, 1992.

with relatively few restrictions as to use. The enterprise is the basis for the cash flow that will be applied to debt service, but it may not be the use of the loan proceeds.

These characteristics are applied in the study as indicators of good outreach. However, the strongest indicator that good financial services are being provided comes not from outside observations but from evidence of client demand. If clients repay their loans, pay full-cost interest rates, and remain in a program as borrowers or savers, it is clear that microfinance services are accomplishing their objectives.[5] Similarly, if a program posts rapid growth rates while maintaining low defaults, there is strong evidence that the services it provides are valuable and relevant to clients.

Social Goals, Empowerment, and Accompanying Services. Emphasizing the value of microfinance services in supporting financial management processes may seem a limited view to some readers. On the contrary, these financial processes have the potential for far-reaching consequences. The paper has already alluded to the economic benefits that can arise from more productive use of resources and protection from risk. These benefits include both poverty alleviation and contributions to economic growth.

Many microenterprise programs state their goals in broader terms. They wish to go deeper than economic indicators, to quality-of-life and social aims. From what is known about the uses of income by the poor, increases in income are likely to be translated directly into improved quality of life -- better nutrition, health, shelter, education, etc. At a more personal level, many microenterprise programs, especially those working with marginal populations, enable individuals to enter the broader society, a process called "social intermediation" by Bennett and Goldberg. Microenterprise finance institutions, particularly those that work through groups, provide a way for severely restricted people, such as women in rural Bangladesh, to begin making contact with the formal institutions that control society's resources.

At a societal level, microenterprise programs are predicated on the belief that access to financial services, and the ability to pursue self-employment or microenterprise activities, is an important means of gaining access to the broader economic life of a country. This might be called economic participation or economic democracy. It involves the kinds of permanent structural changes that provide citizens with an economic stake in their nation and contribute to democracy and political stability. At this broader level, microenterprise finance enhances the contribution of microentrepreneurs to the economy. Microenterprises make such contributions in the forms of employment (for the entrepreneur and workers), supply of goods and services to the low income population, and acting as a safety valve for rural-urban migration and economic contractions.

The effects of microenterprise finance just discussed are associated with the provision of financial services and do not imply the presence of additional, non-financial services. This study does not include organizations with additional specific objectives that are not primarily pursued through

[5]However, if clients are paying less-than-market interest rates on loans, good repayment may only indicate a desire for continuing access to the subsidies implied.

financial services, nor those using financial services as a "carrot" to attract clients to other activities. Thus, there are no programs represented here whose main goal is entrepreneurial training, and none that combines microenterprise credit with an additional sectoral program, such as health or nutrition. However, several programs could offer limited accompanying services, usually either closely connected to the provision of credit, or else available on a voluntary basis. For example, many of the programs offer training and technical assistance in a manner that integrates these activities with financial services.

I.A.ii. Depth of Outreach: How Poor Are the Poor?

For many practitioners and donors, microenterprise finance is all about reaching the poor. However, it is difficult to define poverty in a manner to which all can agree, and next to impossible to apply any such definition systematically to the clients of microenterprise finance institutions in different countries. Nevertheless, a few global statistics can help to establish a general context. The World Bank has collected information about poverty that defines people living on less than US$1 per day (in 1985 dollars) as truly poor. The World Bank adopted this definition after concluding that incomes below this level would be associated with difficulty in obtaining adequate nutrition and other necessities of life (World Bank, 1990; World Bank, 1993). According to this definition, nearly one third of the populations of developing countries are "poor", including 48 percent of people in Sub-Saharan Africa, 49 percent in South Asia, 33 percent in the Middle East and North Africa, and 25 percent in Latin America and the Caribbean.

In reflecting on just how arbitrary this (or any) definition is, one can observe that moderate increases in the income cut-off level increase the percentage of the population counted as poor dramatically. Thus, at a level of $1.50 per day, one half of all people in developing countries would be counted as poor. This figure indicates that there are substantial numbers of people living just above the World-Bank-defined poverty level who would certainly be counted as poor by the standards of high or even middle income countries.

If we apply this reasoning to microenterprise finance, we can estimate that approximately half of the people in countries in which microenterprise finance programs operate can be considered poor, more in Africa and South Asia, fewer in Latin America and the Middle East.

At the lower end of the spectrum, the World Bank defines "extreme poverty" including as those living on less than 75 cents per day, and notes that about two thirds of all people who qualify as poor by the dollar-a-day standard are poor enough to be classified as extremely poor. Several of the microenterprise finance programs studied here concentrate on this lower portion of the spectrum, and an implicit outreach index would give greater weight to reaching such groups.

A number of other factors affect how seriously deficient in access to financial services certain populations may be. In fact, these characteristics can serve as proxies for income indicators that are not generally available. For example, in many countries there are ethnic minorities who are discriminated against in various ways, including lack of access to services from formal institutions. In countries with norms of female seclusion, women may have very little access to

financial services. Refugee and immigrant populations are especially needy, and increasing in numbers. In some settings, lack of land ownership can be a proxy for low income.

Similarly, there are factors that make certain populations particularly difficult to reach with financial services. For example, people living in sparsely populated rural areas or areas with poor roads and communication infrastructure are costly to reach. Services to largely illiterate people requires special efforts to find delivery methods that do not require client reading ability. In some cases, language differences present a hurdle, and again, institutions in countries with female seclusion must make special provisions if they are to reach women. All these factors have the potential to increase the costs of serving such groups.

In considering outreach indicators for microenterprise finance institutions, this study notes both how poor clients are and whether they belong to specifically disadvantaged or difficult-to-reach groups. Those reaching very poor or hard-to-reach clients will be said to have "deep" outreach.

In this study, small loan size is used as the primary indicator of depth of outreach for several reasons. It is exceedingly difficult to measure income levels of microenterprise finance clients, and impractical to require microenterprise finance institutions to apply means tests. In the absence of more direct indicators, loan size becomes the most readily available proxy for income level. It is generally believed, through observation of existing programs, that programs offering very small loans serve very poor clients, and that larger loan sizes correlate with better off clients. It is clear that people with small incomes have the cash flow to make only very small debt service payments. Therefore, if loan size is determined by cash flow, as it should be, small loans will be closely tied to low incomes. The advantage of loan size as an indicator is clear: information on loan size is easy to obtain for every institution and can be compared directly from one institution to another.

However, there are also caveats. First, loan size may reflect the status of the lender rather than its clients. When NGOs face funding constraints, they often restrict the amount of money they lend to each client. Similarly, programs with high percentages of new clients will show low loan sizes because they are still in a getting-acquainted period with clients, during which loans are generally very small. Second, while the correlation between loan size and income level is believed to be strong, there is little empirical research establishing such a correlation. Third, differences across countries in costs of living and doing business make direct international comparisons difficult. Finally, mean (average) loan size tends to be skewed upward. A few large loans can pull the mean up quickly.[6] Medians, modes and other measures of size distribution would be more informative but are rarely available.

[6]In statistical terms, this occurs because the distribution of loan sizes is truncated at zero. In such a distribution, the bulk of the observations fall below the mean.

I.A.iii. The Extent of Outreach: The Scale of Programs

In this study, organizations reaching large numbers of clients are defined as having "extensive" outreach. Most microenterprise practitioners seek a significant scale of outreach. As the World Bank's numbers show, major portions of the world's population fit the definitions of poverty to qualify as potential clients of microenterprise finance. A total of 1.1 billion people now live below the dollar-a-day level (World Bank, 1990). Not all these people are potential clients of microenterprise finance programs, of course. Half are probably too young to work or unable to work because of sickness or old age, although if these people are the dependents of clients, they form part of an indirect client population. Among working people with poverty-level incomes, not all are engaged in microenterprise activities. Many are either wage-laborers or small farmers, although it may be impossible to establish exactly what proportion. Even so, based on these numbers, one can estimate that the number of potential clients for microenterprise finance institutions may be in the range of one to two hundred million. This crude calculation makes scale a relevant indicator. Programs or networks of programs that do not attempt to achieve large-scale outreach are simply not making a dent in the global problem.

Another way to view the importance of scale is to consider the aim of microenterprise finance to increase substantially the access of poor people to financial services. Implicit in this statement is a desire to bring about major structural changes in the financial systems of developing countries. The aim is for countries to develop financial systems that provide very broad access. Such access may ultimately be provided by a variety of institutions, from specialized financial institutions, to NGOs, to formal banks. While the institutional mix may vary, the ultimate aim is clear: many, well-functioning institutions which, taken together, serve the entire spectrum of the population, and compete with each other to serve better. This aim of broad access is relevant even for middle and higher income countries where absolute poverty is less common, but there is commitment to reduce relative deprivation.

In judging whether a given institution has an extensive scale of outreach, comparisons must be made with the achievements of other institutions, keeping in mind the program's age and the size of the poverty-level population in its country. Common sense must be used in assessing whether an institution has achieved significant scale in its context.

This study looks for institutions that excel either in depth or extent of outreach, and particularly for institutions that excel in both.

I.B. Financial Viability - The Key to Sustained Outreach

Practitioners of microenterprise finance are concerned with financial viability because it is a necessary precondition for reaching large numbers of microenterprises with financial services over a sustained period of time. Financial viability allows a microfinance program to maintain its operations indefinitely, becoming independent of concessional funding. This alone is an important goal for donors and practitioners. However, a second function of financial viability is at least as important: strong financial performance allows institutions to access far more abundant sources of funds, i.e., client savings and financial markets in general. Viable institutions can leverage their initial investments (or those of donors) in microenterprise finance

into increasing levels of outreach with small additions of capital. Leverage brings the potential of microfinance to a level in keeping with the scale of the problem it addresses and warrants placing these types of programs prominently within overall economic development strategies.

The situation now confronting microenterprise finance can best be described as follows:

- Successful programs in widely-differing countries have shown that we now have at our disposal financial technologies capable of efficiently bringing quality financial services within the reach of very large numbers of poor households.

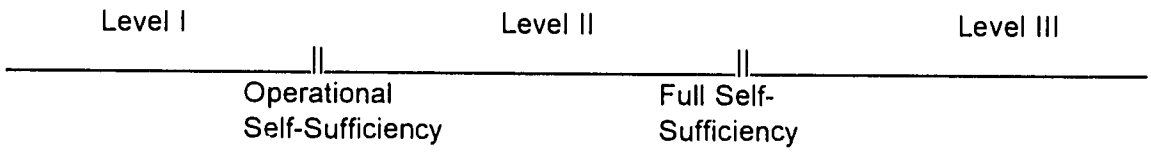
- In virtually no country (with the probable exception of Bangladesh and Indonesia) have programs yet succeeded in reaching anything like the majority of poor households; market penetration by microfinance programs seldom exceeds 5 percent; indeed, few countries have reached 1 percent.

- Even rough calculations of potential market size reveal a scope for microfinance funding far in excess of donor possibilities. For example, in Bolivia alone, with an estimated 600,000 potential microenterprises, it would take $90 million dollars to supply half of potential demand at an average loan size of $300.

If technologies exist to reach vast numbers of poor clients, but clients have not yet been reached due to a lack of funds, ways must be sought to tap commercial financial markets or the national savings pool for those funds. However, the ability to attract sufficient funds depends on demonstrable financial viability by microfinance lenders.

I.B.i. Levels of Financial Self-Sufficiency

Microfinance programs can be placed at various points along a continuum of financial self-sufficiency. This continuum is marked by two important hurdle points, that separate all programs into three levels.



The first hurdle is *operational self-sufficiency*. It refers to the ability of programs to cover all non-financial expenses out of program fees and interest charges. Non-financial expenses include salaries and administrative costs, depreciation of fixed assets, and the cost of loan principal lost to default. These are the elements that define the *spread* institutions must attain. At this hurdle, however, financial costs (i.e., the cost of loanable funds) are not covered. Nevertheless, operational self-sufficiency is a significant step for a microenterprise program. Achieving it indicates that operations are generally efficient, with high client to staff ratios and good control of delinquency and default.

Level I programs, which have not yet crossed this hurdle, are heavily subsidy-dependent. They require constant injections of fresh funds. If these injections are not forthcoming, the program will quickly consume its capital in financing the operational costs of administering its assets, and will cease to exist within a brief period of time. Earlier studies indicate that this has happened hundreds, perhaps thousands, of times. (Buttari, 1994)

The second hurdle is full self-sufficiency. As programs reach this point, revenues cover both non-financial and financial costs, calculated on a commercial basis. Subsidies in the form of concessional funds are no longer needed, and investors can expect a return on equity equivalent to returns that can be obtained elsewhere in the private sector. This is quite a high standard -- profitability without subsidy. It is the same hurdle that private enterprises face. Only a few microenterprise finance programs have achieved it so far, and they occupy Level III. Sustained profits have three effects: 1) they directly increase the program's equity base, 2) they can attract additional outside equity participation, and 3) they encourage others to replicate the experience in hopes of attaining the same levels of profitability.

Level II, which includes programs that have achieved operational self-sufficiency but not full self-sufficiency, is a heterogeneous level, including programs that still rely extensively on soft money, as well as programs on the verge of unsubsidized profitability. Thus, it is crucial to keep the image of the continuum in mind, rather than assuming that all programs at the same level are essentially similar.

Two factors complicate the assessment of viability at any point in time: inflation and expansion. Inflation erodes the value of a program's loan capital. In a high-inflation environment, a 100 peso loan may finance a client's inventory in 1994, but in 1995 the lender would need to supply, say, 150 pesos to provide the same level of support to the client. Financial institutions usually cope with inflation by including inflation premiums in the interest rates they charge, and they usually face a cost of funds that reflects a similar inflation premium. If interest rates are not fully adjusted for inflation and the return on capital falls below the inflation rate, the program will fail to cross the full self-sufficiency hurdle, and the real value of its capital will dwindle. In evaluating programs it is important to consider whether such a situation is temporary or chronic.

Programs that are expanding rapidly also face reduced profitability. Expansion requires investment in staff and facilities that may not be recovered from a revenue-producing loan portfolio for some years. This has the effect of lowering measures of operational efficiency until expansion levels off. Many of the programs in this study have been in rapid expansion modes throughout their lifetimes, as shown in Chapter II. Just as private sector firms may not be profitable every year, so a one-time snapshot of microfinance programs may catch potentially profitable programs below the threshold.

I.B.ii. Leverage

As programs progress along the financial viability continuum, their opportunities for leverage increase. Leverage can be defined as a program's ability to use its capital (whether supplied by donors or private investors) as a lever to obtain additional funds through borrowing or taking

deposits. Leverage is particularly important for donors as they seek to maximize the outreach generated with their resources. In principle, donors should take a perspective very similar to that of private investors wishing to generate high "returns" on their investments, with the difference that donors measure their returns in terms of outreach achieved rather than profit. A central question for donors is thus:

> *If a donor puts one dollar into a microenterprise finance program today, how many dollars of microfinance loans will be in clients' hands several years hence?*

This is the challenge of leverage.

Opportunities for leverage exist at all points on the continuum, but they remain quite limited until full self-sufficiency is approached. Level I programs can leverage funds through savings requirements, but with few exceptions compulsory savings generate only a small fraction, generally less than one third, of associated loans. Moreover, because revenues do not cover operating costs, a donor that invests one dollar in a Level I institution will find that less than a dollar's worth of loan funds has been generated, and each year the amount remaining will decrease.

Level II programs have greater ability to leverage, mainly through borrowing. Programs at this level can usually leverage donor funds by obtaining limited commercial or donor loans on the strength of their ability to break even operationally and maintain a sound loan portfolio. Sustained solid financial performance allows for deeper commercial relationships with banks. At first such loans have typically been backed by guarantees (from donor or technical support agencies), but after a time they have often been offered without a guarantee. At the lower end of the Level II continuum, a donor dollar will yield about a dollar in future loans. At the upper end, present experience suggests that the limits of such leverage may be around two to three times the value of the contribution, but greater leverage may be possible as new ways are found for microenterprise finance programs to tap capital markets.

The greatest leverage occurs when programs become secure, profitable financial intermediaries, as in the case of several institutions reviewed below. Once an institution can demonstrate that it is secure and profitable, whatever its type, it can gain wider access to commercial funding sources. Such institutions can fund their loan portfolios fully in commercial financial markets, either by capturing individual savings deposits or by attracting investors through the issuance of debt securities. It is here that a dollar of donor investment can really pay off, leveraging up to eleven or twelve dollars of microfinance assets after a few years.[7] Beyond this, if one assumes that donor funds are responsible for establishing a commercially successful program that motivated private entrepreneurs to offer similar services, the leverage effect of one dollar invested can potentially far exceed even twelve dollars in microfinance assets.

[7]This leverage factor is consistent with the international standard (Basel Standard) for capital adequacy among commercial banks.

Leverage is an essential concept even when the concern is for reaching the very poor. In the past, there has been a tendency to focus exclusively on loan size as the primary indicator of institutional commitment to poor clients. Overall average loan size of under 300 dollars has been used to indicate that donor investments reach genuinely needy microentrepreneurs. The reality is that financial leveraging can provide a preferred option for donors. Consider the following two hypothetical cases:

> Case A is a Level II NGO microfinance program that makes only small loans. Donor funds are unlikely to be diverted to more affluent members of the micro-clientele. Since the program has managed the difficult task of reaching operational self-sufficiency, each dollar of donor funds produces slightly more than one dollar of sustained poverty lending.
>
> Case B is a Level III licensed microfinance bank, where one third of the loan portfolio goes for poverty lending. This bank can leverage every dollar of its equity with eleven additional dollars of loans and deposits from the general public. Each donor dollar contributed as equity to such a bank will thus generate four dollars of sustained poverty lending.

While these example are hypothetical, there are institutions in this study that fit both profiles. The examples serve to illustrate the importance for donors of encouraging organizations they support to meet the hurdles that qualify them for leverage.

I.C. The Importance of the Right Policy Environment

The policy environment is widely believed to be important for microenterprise finance institutions to achieve substantial outreach and to attain financial viability. Four aspects of the policy environment are thought in particular to be likely to affect microenterprise finance performance and are thus examined in this study. First, the overall level of development of a country, and especially its recent growth, are important in providing the overall climate in which microenterprise finance programs operate. Successful government policies that are reflected in high rates of economic growth, and ultimately in high levels of GDP per capita may be critical for microenterprise finance programs to achieve substantial outreach and to attain financial viability. Second, governments are always judged on the ability of their monetary and fiscal policies to achieve macro-financial stability, that is, low rates of inflation and stability in foreign exchange rates. It is clear that any financial institution, including a microenterprise finance program, will have greater difficulty achieving financial viability and a widespread client base the more it has to cope with the risks and uncertainties of macro-financial instability. This study thus examines the impact of the rate of inflation and variability in the exchange rate on the success of microenterprise finance programs in achieving their twin goals of viability and outreach.

Third, the extent of financial repression (or liberalization), that is, the extent of government controls over interest rates and the existence of widespread directed credit programs, may affect the ability of microenterprise finance institutions to achieve substantial outreach and to attain viability. To the extent that government interest rate controls effectively limit the interest rates

that microenterprise finance programs can charge their clients who, in general, are likely to be especially risky and costly to serve, the more difficult it will be for these programs to achieve success. On the other hand, interest rate controls that effectively constrain financial institutions that are potential competitors may in fact benefit microenterprise finance programs if they themselves are not so constrained. Furthermore, directed credit programs that attempt to target microenterprises with subsidized low-interest loans may make it more difficult for microenterprise finance programs to reach these same clients on a sustainable basis. This study thus examines the impact of these two key aspects of financial repression on the success of microenterprise finance programs in achieving financial viability and substantial outreach.

Fourth, the regulatory environment can be highly significant for the success of microenterprise finance programs. In particular, the regulatory environment typically sets down rules and regulations with which deposit-taking institutions must comply, and these can be especially important if microfinance institutions are looking toward deposit mobilization as a way to expand their leverage and the range of their financial services to clients. In addition, the overall legal environment can have a major impact on the ability of lenders in general, and microenterprise finance programs in particular, to enforce loan contracts effectively. This study thus examines the impact of the legal and regulatory environment on the success of microenterprise finance programs in achieving financial viability and substantial outreach. As will become apparent in the analysis of successful microenterprise finance programs that follows, a key element of success is the ability of microenterprise finance programs to develop techniques that are appropriate to their particular policy environments, just as they must become expert in dealing with their particular market niches of potential clients.

I.D. Study Methodology

I.D.i. Program Selection

The eleven programs analyzed in this study and briefly described below were selected primarily on outreach and financial viability criteria. Over the past 15 years USAID has supported a very large number of PVO, NGO, and other lenders to the poor or to very small businesses (probably well into the hundreds). A small minority (no more than a few dozen) have performed in a manner that has enabled them to achieve both solid outreach and financial viability. The present study is based on a sample of 11 of the best institutions. It is in no way a random sample. Rather, the intent in selecting institutions was to learn from successful examples. Programs were selected because they have demonstrated deep and extensive outreach in their local context, as well as offering good quality services. Initial criteria included loan size, number of borrowers and a reputation for financial strength. In addition, attention was paid to geographical spread, diversity of financial technologies and institutional types. Some good programs were eliminated from consideration because they could not provide high quality data for the five year period covered by the study. Others were eliminated simply because there were already other similar programs in the study.

This sample does not include any credit unions, largely for practical reasons. Credit unions differ from microenterprise finance programs in ways that make direct comparisons difficult.

For example, the proper point of comparison is not a single credit union (generally very small), while national credit union systems generally lack a specific focus on micro-level clients that would allow comparative analysis. However, credit unions do provide financial services to microenterprises, and many conclusions of this study would apply equally to credit unions. They should be considered an important part of the broader microfinance field.

Table 1: Age and Type of Selected Institutions

Name (Country)	Age	Type of Institution	Urban/Rural
BRI Unit Desa System (Indonesia)	10	Division of Gov't Commercial Bank	Both
LPD (Indonesia)	10	Village/Government-owned bank	Both
BKD (Indonesia)	40+	Village-owned financial institution	Rural
ADOPEM (DR)	12	NGO	Urban
Actuar (Colombia)	6	NGO/Finance company	Urban
FINCA (Costa Rica)	10	NGO	Rural
Kenya Rural Enterprise Programme	4	NGO	Both
ACEP (Senegal)	8	NGO/Credit Union	Both
BRK (Niger)	3	NGO	Rural
Bancosol (Bolivia)	7	Private commercial bank	Urban
Grameen Bank (Bangladesh)	18	Gov't/member owned, specially licensed bank	Rural

Outreach. Special emphasis was placed on selecting at least one institution that focuses exclusively on the very poor in each of the three major geographical regions. In Indonesia, two village level programs were selected, the LPDs of Bali and the BKDs of western and central Java. In Bangladesh, the Grameen Bank was chosen. In Latin America, a FINCA program in Costa Rica was chosen, and in Africa K-REP and BRI-Niger were chosen. These programs reach very small economic activities. Several of the programs finance the poor to start very small enterprise activities besides lending to those who have already started.

In addition to these six programs, five other microfinance programs were chosen: BRI, BancoSol, Actuar Bogota, ADOPEM, and ACEP. These programs have traditionally reached a broader range of poor clients. Although they have by no means neglected the very poor, most have also reached somewhat better off microenterprises with financial services. They have average loan sizes about twice those of the village banking programs. In all cases, the programs' clients would not have been served by mainstream financial institutions.

Most of these programs encourage the poor to save. However, only the Indonesian programs offer deposit services to non-borrowers in the fashion of true banks or other financial intermediaries. One other program is on the verge of doing so on a broad scale (Bancosol).

Finally, each program has either reached substantial market coverage or demonstrated its ability to do so in the near future.

Financial Viability. The second major selection criterion was financial viability. Programs selected were considered to have superior financial performance over time, according to data available prior to the study. The study explores the financial potential of the best service technologies available today for reaching the poorest microentrepreneurs in diverse local contexts.

I.D.ii. Data Gathering and Analysis

Data were gathered for this study through visits by analysts to most of the programs selected. However, special visits were not made to Grameen Bank, Bancosol, Actuar or ADOPEM, since adequate data were available from prior visits, public documents and information available to the authors. Grameen Bank data were obtained exclusively from Khandker et al. (1993) and Grameen Bank annual reports. For each program, analysts collected data on outreach and financial performance over the previous five years following detailed instructions designed to ensure data consistency across programs.[8] Financial analysis was carried out according to a framework commonly used by financial institution examiners to assess overall financial performance. The framework focuses on capital adequacy, asset quality, management, earnings, and liquidity, and thus is commonly known as CAMEL.

The analysts had considerable difficulty collecting standard outreach and financial data from most programs. In fact, in many cases the only data available had been prepared primarily to suit donor requirements rather than internal management needs. This was particularly true with respect to outreach information. There was thus very little consistency in the type and frequency of information gathered on outreach, making generation of comparative tables difficult.

On the financial side, information available from most programs was highly aggregated, with little detail on the nature of accounting adjustments employed or the policies underlying key accounts such as loan loss provisions. While larger, more formal institutions produce audited financial statements using a chart of accounts appropriate to a financial institution, several others report in other formats. Even where audited financial statements were available, information was often highly aggregated, and/or non-standard accounting practices were not fully explained. In most cases, analysts were able to flesh out information deficiencies through intensive discussions with financial managers in the programs. The general approach was to develop balance sheets and profit and loss statements according to a standard format, so that institutions could be compared. The analysts did not audit the institutions, but rather sought greater clarity and detail in the information. For example, the analysts reviewed internal management reports when audited financial statements presented information too aggregated for the study. In some cases, analysts had to make reasonable assumptions or classify accounts in somewhat less exact ways in order to fit them into the general framework developed for the study.

[8] The resulting program descriptions and analysis are on file with CDIE, but as many contain confidential information, they are not for general circulation.

I.D.iii. Financial Data Adjustments

Once the financial data were standardized with respect to format and definition, several adjustments were applied to all institutions. These adjustments make it possible to compare financial performance across all the institutions. They are an integral part of applying the framework for analyzing financial viability outlined above.

This study focuses on one of the most commonly applied measures of financial performance, return on assets, a measure of profitability. However, as Jacob Yaron has described, standard accounting measures of profitability are not valid for analyzing the performance of institutions receiving subsidy: accounting profits are simply a residual of true profits (or losses) and subsidies received. Thus, a highly subsidized program will appear more profitable than a better-performing, subsidy-free program. Yaron addresses this problem by proposing the use of a subsidy dependence index (Yaron, 1992a). The index relates the value of subsidies to the value of program revenue. This study takes a different approach: it makes adjustments in the financial statements, so that they can be presented as if the institution was not subsidized. Conceptually the two approaches are entirely compatible: they compensate for the same shortcomings in standard financial statements. The approach used in this study in effect places the statements on a fully commmercial basis, as if the institutions were not subsidized, and makes the standard return on assets measure a valid reference for comparing the institutions against each other, and against private sector standards.

The adjustments made are as follows:[9]

1. Arrears and Loan Losses: Application of standard arrears and loan loss provision policies is essential for meaningful comparisons. This adjustment separates the loan portfolio into on-time and overdue loans, using the same definition of these terms for such institutions, as available. The estimated cost of loan defaults is reflected in the provisions in the profit and loss statement. These provisions for losses, based on historical experience, appear in the balance sheet as a liability or a subtraction from assets.

2. Inflation: All programs, especially those operating in high-inflation environments, must take into account the effect of inflation on the value of their assets and liabilities. The adjustment taken to compensate for inflation affects primarily the stated value of non-monetary assets (generally fixed assets) and the real value of equity.

3. Subsidized funds: These adjustments apply a commercial cost of funds to all subsidized fund sources, notably soft loans and grants. These funds are priced as if they were raised instead on local financial markets, as an independent financial institution would have to do.

Finally all data were converted from nominal to real terms in local currencies and then into 1993 US dollar terms, so that programs could be compared to one another.

[9]Annex A contains the detailed instructions for data collection and adjustment used by the analysts.

It is not appropriate to use the analysis presented here to make direct judgments about whether one of the programs studied here is "better" than another, for two reasons. First, the results presented here represent financial performance for only one year, 1993. Results may vary significantly from year to year, as a consequence of major decisions, such as adjustments in salary levels, hiring of new staff prior to expansion, interest rate policy changes, institutional type transformation and as a consequence of external factors. Virtually none of these programs operates in a steady state; all are characterized by high rates of growth. Thus, it is critical for the reader to focus on the collective outreach and financial performance of the group of institutions selected rather than making individual comparisons. Secondly, programs operate in widely differing cultural, economic, and demographic contexts. Results which appear to be better (for example a higher rate of return on assets) may not be replicable in a different context.

CHAPTER II. STUDY RESULTS

This chapter presents the results of the analysis of the eleven selected institutions according to the framework outlined in Chapter I, covering, in turn, outreach, financial viability, and the policy environment.

II.A. What Have Some of the Best Programs Accomplished?

Over the past five years, good microenterprise finance programs have made large advances in outreach and financial viability. Many of the best programs have sustained very strong growth rates and, in some cases, have started to achieve significant market penetration. The programs studied grew on average of 200 percent over the past three years, although some of the smaller and newer programs grew as much as 100 percent annually both in terms of total assets and number of clients reached. Five years ago, few of the selected programs were self-sufficient. Today ten of the eleven are operationally self-sufficient, and five have crossed the hurdle of full self-sufficiency, now generating returns on assets that would be considered adequate by private banking standards.

II.B. Outreach

II.B.i. Service Quality

These institutions have successfully adapted their services and service delivery methods to fit their client groups. Service quality is generally high and evidence of client acceptance is strong, as will be shown below.

II.B.i.a. Lending. The programs can be categorized according to the three lending methodologies they use: individual lending, solidarity group lending, and village banking. The three Indonesian programs rely exclusively on individual loans, as does ACEP in Senegal. BRK in Niger and Actuar in Colombia place a minority of their funds in individual loans. In these programs, individuals typically need a credit reference from someone the program trusts, in addition to some type of collateral. The types of collateral used and the legal means of securing the collateral generally fall below the level a commercial bank would require. In most instances, individual loans are larger than loans under group-based methods. The LPD and BKD systems in Indonesia, which make extraordinarily small loans on an individual basis, are exceptions.

The Latin American programs (except FINCA), Grameen Bank, and K-REP use a solidarity group method. A small group of clients (generally four to seven) provide crossed guarantees, obviating the need for real collateral. Finally, there is one village banking program, FINCA Costa Rica, in which loans are made to groups of thirty or more people, who then administer loans to individual group members. K-REP also has a pilot program based on pre-existing groups. This and the LPD system, a network of very small, village-based institutions, bear some resemblance to the village banking model. The BRK program of Niger, which uses somewhat larger groups, includes an eclectic blend of features from the individual, solidarity and village banking models. In general, the solidarity group and village banking programs have smaller average loan sizes than individual loan programs.

The main loan product of these institutions is a short term working capital loan, usually at a term of 12 months or less and carrying an interest rate somewhat higher than standard

commercial bank loans in the same locale. Terms applied to loans vary by institution, albeit within a fairly narrow range. Repayment frequency varies from weekly to bi-weekly to monthly, with shorter loan terms generally requiring more frequent payments. A wide range of fees and specific conditions for loans are applied, such as BRI's prompt payment incentive which gives on-time repayers a lower interest rate.

Despite surface differences, there are striking similarities in the underlying principles found throughout the programs, such as the use of groups, social pressure and unconventional collateral to motivate repayment, the focus on short-term working-capital loans, and relatively high interest rates. Another underlying principle of most programs is graduated lending, in which the borrower's capacity and willingness to repay are determined through a series of short-term, ever-increasing loans renewed on the basis of the borrower's repayment record. Programs expect borrowers to remain clients for an extended period. Client graduation to more formal financial institutions is generally not a goal, although some programs (Grameen and FINCA) have a maximum loan size that eventually forces their more successful borrowers to seek financing elsewhere. Most programs are based on the recognition that the vast majority of their clients, even clients that grow substantially, will remain too small and informal to be picked up by the banking sector as commercial clients. Several institutions offer larger and longer term loans to proven customers. Grameen offers housing loans, BRI and Bancosol offer fixed asset loans, and Actuar offers agricultural loans. To obtain these loans, most institutions require borrowers to have participated in a series of shorter-term loans to qualify, or to have saved over a substantial period.

These lending methodologies result in very high quality credit services compared to those offered by other, more traditional institutions. They bring the loan product physically close to the borrower and tailor the product to the borrower's opportunities and abilities, thereby bringing transaction costs to a level that makes them attractive to borrowers. Turnaround time on new loans and renewal applications was consistently less than two weeks, and in most cases a matter of days, as opposed to many weeks or months at most commercial banks or traditional credit programs. In virtually all cases, the loan a borrower ultimately receives is very close to the loan expected, as loan officers have developed the art of client/lender communication. Almost all the institutions carry out a significant part of the loan application process at the borrower's place of work.

II.B.i.b. Savings. Of the institutions reviewed, only the Indonesian banks offer widespread voluntary deposit services to the general public in the communities where they operate. In these cases, the most successful savings instrument is a highly liquid passbook account that pays a somewhat lower rate of interest than time deposits or the other less liquid savings accounts that these same institutions also offer. As much as 75 percent of funds mobilized are generated through these liquid instruments, demonstrating that new savers generally prefer liquidity over returns when choosing among deposit options. Bancosol embarked on a program to implement voluntary savings services in Bolivia in 1994, but the early results were too preliminary to include in the present review.

A second group of programs, Grameen, K-REP, FINCA, and the BKDs, incorporate compulsory savings requirements into their loan methods. However, these savings services do not reach

beyond the borrowing clientele, and the use of savings is determined by the group (not by individual savers). Funds are often not readily accessible, and interest rates are often below market. Thus, these programs cannot be judged to provide high quality savings services, although they may play an important role in the overall service methodology. For example, they act as default guarantees and provide institutions with a source of loan funds. Grameen Bank has now generated client savings almost as large as its loan portfolio.

Two other programs, Actuar and ACEP, cannot offer savings deposits in the manner of a commercial bank and do not have compulsory savings requirements. However, Actuar has just purchased a finance company license to allow it to take voluntary deposits in the future, and ACEP is taking steps to incorporate as a credit union.

II.B.i.c. Other Services. Finally, some NGOs offer other financial and non-financial services. Two that are particularly active are Actuar and Grameen. Actuar operates a wholesale depot for raw materials, construction materials, and other inputs microenterprises use. Actuar receives a margin of 6 percent on average on sales at the center, while microenterprises realize savings of up to 15 percent. Ultimately, this activity may generate substantial income for Actuar. Grameen Bank also carries out a variety of non-financial activities, mostly built upon its social agenda, the Sixteen Decisions. These include distribution of seeds, organization of village schools, and promotion of practices such as family planning, girls' education, and marriage without dowry. Grameen also invests in its own for-profit ventures, including projects in fish hatching, tube wells, and textiles.

For the most part, the other institutions studied did not engage in significant non-financial service activities, preferring to concentrate instead on achieving high levels of credit and savings outreach through market penetration and financial viability.

II.B.i.d. Evidence of Client Acceptance. As a group, the institutions studied have met the most important test of service quality: client acceptance. While for each measure given below there is generally one institution that does not perform well, the averages for the group as a whole are quite impressive, and most of the institutions score well on several of these measures (see Table 2).

Table 2. Evidence of Client Acceptance at Studied Institutions

Measure (in percent; n is number of institutions for which the variable was observed)	Range	Mean
Annual growth in number of borrowers (n=11)	-10 to 120	40 (approx.)
Annual growth in loan portfolio (n=10)	0 to 245	76 [a/]
Annual growth in savings (n=4)	5 to 38	27
Percent of portfolio overdue more than 90 days (n=11)	0 to 20	5
Real effective interest rate (n=10)	-11 to 51	13

[a/] Median is 58 percent. *Locally available data gathered by field team members.*

High and sustained growth in all measures of scale provide evidence of strong client demand. The growth figures do not stand alone, however. They are validated as indicators of service quality by low delinquency (averaging 5 percent, with average loan loss rates significantly less) and client willingness to pay interest rates that are significantly above the inflation rate (with an average premium above inflation of 13 percent). As mentioned above, loan recovery is enhanced by the short terms of loans, frequency of payments, personal contact with loan officers, social pressures, and especially the offer of another, larger loan. The effective real interest rate will be discussed below as a crucial determinant of financial viability. At this point we merely note that clients are flocking to programs even though they are paying a substantial premium over inflation. Another indicator, dropout rates, was not widely available. However, Grameen Bank maintains information showing very low client turnover from year to year. Many clients in Grameen's older offices have been with the program from five to ten years. These indicators give indirect evidence that the institutions offer something of value at lower total transaction costs to clients than do either other formal financial institutions or informal sector alternatives.

II.B.ii. Depth of Outreach: Reaching the Very Poor

All selected programs reach very small businesses that would otherwise be excluded from formal financial services. Most reach the most minute of economic activities in their local environments. This section reviews loan size information (the only outreach indicator available for all programs) and then looks at more qualitative indicators of ability to reach the very poor.

II.B.ii.a. Loan Size. Average loan balances at the selected institutions ranges from $38 at the BKDs of Indonesia to $1,645 at ACEP in Senegal (see Table 3).[10] However, most of the programs (six of eleven) cluster in the range of $200 to $400. In part, this range of loan sizes results from an explicit decision in the study to select institutions working across the spectrum of microenterprise finance. Moreover, it is not particularly useful to compare loan sizes in the absence of contextual information, as country circumstances differ greatly. A context can be supplied by comparing the average loan size at a given institution to GNP per capita in that country.

Table 3. Depth of Outreach at Studied Programs

Measure	Range	Mean
Average loan size (US dollars)	38 to 1,016	340
GNP per capita (US dollars)	183 to 1898	804
Average loan/GNP per capita	5% to 136%	60%
Percent women clients	24 to 100	52%

Locally available data gathered by field team members.

[10] Loan sizes discussed here are obtained by dividing the amount of the loan portfolio by the number of active borrowers. This yields the average balance of loans outstanding, which is a standard way of measuring loan size and the only measure available consistently across programs. Initial loan size may be significantly higher.

Three programs operate in extremely poor countries, where GNP per capita is less than $400: Bangladesh, Niger, and Kenya. Six programs operate in four slightly less poor countries, with per capita GNP between $400 and $1,000: Indonesia, the Dominican Republic, Bolivia, and Senegal. Finally, two programs, in Colombia and Costa Rica, operate in countries where per capita GNP exceeds $1,000. It appears that programs in the poorer countries tend to serve a more mainstream clientele, while programs in the better-off countries tend to focus more exclusively on the poorer segments of the population. For example, Grameen Bank's average loan size of $113 represents 54 percent of GNP per capita in Bangladesh, whereas FINCA's average loan size of $317 represents only 17 percent of GNP per capita in Costa Rica. Loans in Costa Rica reach a relatively poorer population than those in Bangladesh although, in absolute terms, the clients in Bangladesh are almost certainly poorer. Actuar, FINCA, ADOPEM, BKD and LPD target their services more specifically to the least well off in their local contexts than do Grameen, BRI or Bancosol. In the case of the BKD, loans are extremely small, only 32 dollars on average in East Java where GNP per capita is 610 dollars a year (5.2 percent). The very small size of loans in these systems ensures that they go only to the poorest residents since more affluent residents would not find such loans worthwhile.

This range of results suggests that in poorer countries microenterprise finance programs tend to serve a broad sector of the population. In more affluent countries, microenterprise finance reaches a relatively smaller segment of the local population. This has implications for institutional development strategies in each context and costs of administering microenterprise finance programs. In poorer countries, it may be more appropriate to focus less on targeting a particular subsector and more on the development of an effective financial system for the bulk of the population, while in more affluent countries development of a specialty institution may be more approporiate.

The three African programs show average loan sizes ranging from 63 to 218 percent of GNP per capita, surprisingly high compared with programs in other regions, and seemingly not in line with the conclusion just stated. ACEP clearly is an exception in that it consciously focuses only on the upper end of the microenterprise spectrum. However, both BRK, with average loans of $295, and K-REP, with average loans of $211, are not as low on the spectrum as might be expected. One conjecture as to why these two programs are relatively high according to this measure is that the programs do not serve the subsistence farmers who are the poorest inhabitants of Kenya and Niger.

For a more complete picture of the depth of outreach, loan size distributions are needed. Unfortunately, very few institutions studied were able to provide such information. Distributions are relevant for determining whether programs with relatively high average loan size nonetheless serve a significant number of very poor clients. One must recognize that even for a program with a relatively high average loan size, say ADOPEM at $307, a substantial majority of its clients receive loans well below this amount. The median and the mode are generally well below the average, so that in a typical institution, even though half of loan funds are invested in loans above the average size, well over half of the *clients* have loans below the average. Thus, in order to determine just how deep outreach is at programs like Bancosol or BRI, it is crucial to know their median and mode loan sizes. Lacking that information, those associated with these institutions generally report that Bancosol serves a large number of very

poor clients with very small loans, while BRI allows other Indonesian institutions to focus on the poorest clientele.

BRI's strong claim to depth of outreach lies mainly in its savings services, which reach deep into rural communities. Its provision of savings services brings it to what is estimated at one third of all households, including those of the very poor. BRI has five times as many savings accounts as loans. Average savings size at BRI is 181 dollars.

It is safe to conclude that all programs with the exception of ACEP have deep outreach, and, while the depth of outreach varies, the main difference is whether a given program serves exclusively the very poor or a mixture of very poor and somewhat better off clients.

II.B.ii.b. Qualitative Indicators. On a more qualitative level, it is possible to make several observations about depth of outreach. For the most part, programs select clients who are poor or likely to be underserved.

The 11 programs reach large numbers of women. Some programs predominately reach women, either by design or by virtue of the market they serve. Grameen and ADOPEM reach women because of a specific policy decision, as seen by the fact that 94 and 100 percent of their clients, respectively, are women. K-REP has recently made a decision to focus more on women, because of their stronger repayment performance and willingness to form groups, and the female participation rate is rising. FINCA International has also decided to focus on women, though the country program studied, FINCA Costa Rica, has remained non-targeted and serves relatively few women. Among programs focusing on women, motivations generally include the belief, or experience, that women are good credit risks and that women are more likely to experience poor access to resources and services. Other programs are open to both women and men without gender preference. The resulting female participation rate is therefore determined by the prevalence of women in client groups served and by features not studied here that may make it easier or harder for women to access the program. There is some correlation between programs offering smaller loans and programs serving more women, but the correlation is far from perfect, with major exceptions, such as Bancosol, which serves 71 percent women despite having a relatively high average loan size.

The programs studied show that microenterprise finance can be successful in both rural and urban areas. Several programs are primarily urban or began as urban programs: Bancosol, Actuar, ADOPEM and K-REP (Juhudi). Several others are primarily rural or began as rural: BRI, LPD, BKD, FINCA, BRK and ACEP. At present, however, several rural programs have moved into urban areas, and vice versa. Only Grameen Bank, BRK and FINCA remain exclusively focused in the rural areas. Successful methodologies transcend the rural/urban divide.

However, among rural programs key determinants of success are believed to be reasonably high population density and adequate access to communications, while among urban programs a key determinant is social cohesion. Extremely high population densities in Bangladesh and Indonesia seem to be important in explaing the large scale achieved by the institutions in those countries (see next section). However, the other institutions demonstrate that population density does not explain financial viability, as subsequent discussions will show.

Qualitative descriptions show that many clients are genuinely poor and often severely limited in life choices. For example, Grameen Bank largely serves rural landless women, undoubtedly among the poorest people in the world, who face severe culturally-imposed restrictions on their behavior. Most are illiterate, and many have not previously engaged in an income-generating activity. Many have never handled money or travelled alone outside their villages. Economic activities of typical Grameen clients are raising a dairy cow or other livestock, paddy husking, or other rice-related activities; these account for two thirds of Grameen client activities.

BRK's clients are similar. They live in one of the world's poorest countries, Niger, with a life expectancy of 41 years, the highest under five mortality rate in the world, and 9 percent literacy. Typical BRK borrowers are small traders in agricultural products and consumer goods, artisans, and miscellaneous service providers. Most engage in a variety of productive activities, in order to diversify their risks and take advantage of seasonal or occasional opportunities to generate income, as appropriate given Niger's harsh physical environment. For example, one client visited operated a scrap metal business, but during the main farming season sold hand-made hoes and other farm implements. Another client bought peanuts to press into oil and sell; then fed the remainder to his camels and goats.

FINCA, a rural program in Costa Rica, has traditionally supported business start-ups by poor clients. It is the only program of its type in that country. Actuar concentrates most of its effort in the poorest areas of Bogota, squatter settlements of recent immigrants from rural areas.

These client characteristics pose significant challenges. Illiteracy, lack of mobility, lack of social cohesion, and geographical inaccessibility all affect one or more of the programs. Although these client characteristics create significant barriers and make the populations difficult to serve, these programs are serving them. As the sections below on financial performance will show, they are doing so without incurring unsupportable costs.

II.B.iii. Extensive Outreach: Scale of Coverage

Several programs studied here are already making contributions on a national scale, and most of the others are growing so quickly that they, too, can be expected to achieve national importance. Nine of the eleven programs grew at impressive rates in recent years, averaging from 14 to 120 percent annually measured in total number of borrowers. As Table 4 illustrates, several small and recently established NGOs have been able to sustain exceedingly high growth rates during the past three years, while the older programs tended to grow more slowly, although still at impressive rates (e.g. Grameen Bank's 15 percent). At current growth rates, BRI Unit Desas, BKDs, LPDs, Grameen, Bancosol, and Actuar will all be clearly preeminent in their market segments within a very few years, if they are not already. The other programs studied could also become preeminent if they build on their achievements in financial viability.

TABLE 4: Growth of Outreach of Selected Microenterprise Finance Programs

Program	Number of Borrowers, 1993 ('000)	Avg. Percent Annual Growth in Number of Borrowers	Number of Savers, 1993 ('000)	Avg. Percent Growth in Amount of Savings
K-REP	5	120	5	N/A
FINCA	5	20	5	N/A
Grameen	1,587	15	1,587	N/A
BancoSol	46	71	N/A	N/A
BRI	1,897	4	11,325	28
BKD	907	-10	817	4
Actuar	32	30	N/A	N/A
LPD	145	14	379	34

Note: Programs with compulsory savings generally have the same number of borrowers and savers.
Locally available data gathered by field team members

The largest programs, in Indonesia and Bangladesh, have already achieved important coverage. For example, the LPD system in Bali is active in fully half (650) the enumerated villages on the island (1,305). In the villages it reaches, any resident in good standing who is approved by the community's representative (village chief) has access to a loan. Virtually all residents open savings accounts. Since local units are owned by their communities, and 20 percent of the net profits at the end of the year is distributed to community projects, residents have an important additional incentive to save. Grameen Bank has similar market outreach, covering almost half of the villages in the country as of 1992. These two programs probably have the deepest market penetration, although they are not the largest. The LPD system reaches 200,000 borrowers and 500,000 savers, while Grameen reaches 1,860,000 borrowers/savers.

Both the BKD and BRI networks in Indonesia are larger in absolute terms. The BKD system has nearly 1 million and the BRI Unit Desa System nearly 2 million borrowers. The BRI Unit Desas have reached almost 12 million savers, 6.5 percent of the entire country's population. With its 3,889 branch offices throughout the country, BRI has established a physical presence across Indonesia and is possibly the largest branch network of any bank in the world. BKDs, independent municipal level microbanks supervised by BRI, number 5,345. Established in 1898, BKDs have achieved impressive market penetration in eastern Java and the island of Madura (20 percent of the villages in each place).

No other program studied even approaches these levels of nationwide coverage or penetration. However, two programs have achieved a scale unprecedented for their countries and for microenterprise finance in Latin America. Bancosol has reached about 50,000 microenterprises throughout the country (in addition to the 10,000 that its NGO mother, PRODEM, still administers). Estimates are that there may be as many as 600,000 families that operate in the

informal sector that could be considered the target population of microenterprise finance in Bolivia, though not all as credit subjects. Under these assumptions, Bancosol/PRODEM has already covered 10 percent of the potential market with loans. Actuar, which has approximately 37,000 clients, has probably reached 5 to 8 percent of potential Bogota-based microenterprises. Growth prospects for these two institutions are strong, if current trends continue. Comparing Bancosol and Actuar with the Asian programs reveals that they began quite recently, in 1987 and 1989, respectively. Grameen Bank in Bangladesh took over a decade to reach nationwide scale. The BRI Unit Desa system had been in existence as a nationwide program for over a decade before it was transformed in 1983 to be an enterprise-oriented system, and the BKD and LPD systems are built on long-existing institutional bases (and were initially subsidized by government).

The remaining programs operate on a significantly smaller scale. Although data are not available to estimate the degree of market penetration in these cases, these programs would not show more than 3 percent coverage. Nevertheless, most of these institutions are the largest in their countries. Some programs, such as K-REP and BRK, are still very new. FINCA is focused in Costa Rica on a niche (poor farmers) of relatively limited size, as is ACEP with its focus on upper-end microenterprises. ADOPEM is growing rapidly and likely to achieve a significant scale in the coming years.

The findings from these programs show that there is no clear trade off between reaching the very poor and reaching large numbers of people. In fact, some of the largest programs (Grameen, BKD) have among the smallest loan sizes. Some observers have argued for an exclusive focus on the poorest clients, with the objective of poverty alleviation. The data assembled here, and the arguments for financial leverage, suggest mixed programs, serving a range of clients, can also be highly effective in reaching the poorest. It is scale, not exclusive focus, that determines whether significant outreach to the poor will occur.

II.C.i. Financial Viability

Chapter I described financial self-sufficiency as a challenge of crossing two hurdles: first, operational self-sufficiency, at which point program revenues cover all administrative costs, and second, full self-sufficiency, in which case revenues also cover the costs of raising funds on a commercial basis, without subsidy. Through the adjustments described in Chapter 1 and elaborated in the annex, each program's financial statements have been put on a standardized basis, which allows their self-sufficiency to be measured using standard tools of financial analysis.

Traditionally, primary indicators used to measure the overall financial performance of banks are "return on assets" and "return on equity" ratios. Both measure net income generated by a bank's activities. The first measures income generated as a percent of the assets used to generate it, in other words, the productivity of the bank's loans and investments. Return on equity measures net income as a percent of the owners' capital investment. Thus, this ratio measures productivity of the capital invested in the enterprise. For a microenterprise finance program to be fully free of subsidy, the return on equity should at least equal the return available on alternative investment opportunities. If not, the owners are subsidizing the institution. Positive returns on

assets and equity ratios commensurate with those obtained by commercial banking establishments in the same economies provide the criteria for classifying a program as fully self-sufficient (Level III). Because the equity structures of these programs differ so greatly, however, return on equity is not as revealing as it would be for a commercial bank. The focus of analysis here is thus return on assets. In addition, the analysis looks at operational self-sufficiency, defined as revenue from clients as a percentage of operating expenses. Programs qualifying as Level II have revenues that exceed their operating costs.

Table 5 shows the financial results obtained by the selected programs during 1993.[11] Results are expressed in inflation adjusted (real) terms and reflect the adjustments made by the study team described in Chapter I.

Table 5: Financial Viability Of Microenterprise Programs, 1993

Program	Operational Self-Sufficiency	Return on Average Assets
LEVEL I: Subsidy Dependent		
BRK	44	-11.5
LEVEL II: Operationally Self-sufficient		
K-REP	106	-18.5
FINCA	98	-6.3
Grameen	105	-3.3
ADOPEM	94	-0.8
ACEP	142	0.1
LEVEL III. Profitable		
BancoSol	107	1.0
BRI	113	1.8
BKD	197	3.2
Actuar	124	4.9
LPD	148	7.4

Locally available data gathered by field team members.

[11] Data are based on 1993 results to reflect the most recent performance given the relative youth of some of the programs studied. Five year data were analyzed to verify that 1993 results were not either extraordinarily positive or extraordinarily negative. In the case of BRI, 1992 and 1993 data were averaged given that both years were atypical. This reflects the intent of the paper to describe the frontier of financial performance in microfinance institutions rather than being a reflection of average performance.

All but one program has crossed or met the initial hurdle of operational self-sufficiency. The only Level I program is BRK, in Niger, also the newest program in the sample. BRK is perfecting its very promising service delivery methodology. However, it has not yet mastered the management challenges required for efficient operations.

The ten remaining programs cover the cost of day-to-day operations from income on assets. Five programs fall within Level II (see table). Among Level II programs the range of performance is quite broad. Some of the programs are barely operationally self-sufficient and still have a negative return on assets. Others are quite near full self-sufficiency. Moreover, the factors keeping institutions at Level II rather than Level III differ greatly. For example, K-REP, Grameen, and ADOPEM are all expanding rapidly, so that their costs reflect investments in capacity that have not yet generated the full returns they are capable of. Several programs have reached operational efficiency at a relatively small scale, as low as 2,000 borrowers. Apparently many of the economies of scale in delivery of services can be achieved in the early stages of expansion. Some of the programs remain in Level II largely as a result of their interest rate policy vis a vis inflation, as will be discussed in detail below.

Among Level II programs there are wide differences in the amount of leverage used. K-REP and FINCA have only the leverage of compulsory savings requirements, relying on grants for all their loan capital. ADOPEM and Grameen Bank obtain funds through both soft loans and commercial loans from banks. Grameen Bank's worldwide fame brings it extensive access to such sources.

The five remaining institutions, three in Indonesia, Actuar in Colombia, and Bancosol in Bolivia, generate positive fully adjusted returns on assets, are profitable without subsidy, and are thus classified in Level III. None of these programs should yet be considered financially stable since, without exception, they face important fluctuations in their cost structures due to their rapid expansion and related administrative and staff adjustments. Nevertheless, in any given year, several microenterprise programs generate returns that are competitive in their local banking sectors.

There is a strong connection between achieving Level III and leverage. The three Indonesian programs and BancoSol are all licensed financial intermediaries, and Actuar, also at Level III, is beginning to operate through a licensed financial institution. Not all are equally leveraged, however. BKD relies almost entirely on retained earnings to fund its loan portfolio. As a result, its 3.2 rate of return on assets gives rise to only a 3.8 percent return on equity. On the other hand, Actuar is a highly leveraged NGO (through loans from banks) whose slightly higher (4.9 percent) return on assets equals a 22 percent return on equity. Therefore, a dollar invested in BKD equity would yield investors less income than a dollar in a liquid savings account, while a dollar invested in Actuar would double every three years. BancoSol raises most funds from local capital markets and is developing the capacity to raise funds by offering deposit services and should shortly reach standard commercial bank leverage ratios.

These results offer a resoundingly positive answer to one of the initial questions posed in this assessment: *financial services can be provided to the poor on a financially viable basis.* A limited form of financial viability, defined as operational self-sufficiency, can be achieved in a

range of settings and client populations by institutions of varying origins.

With regard to full self-sufficiency, the results are less conclusive. Microfinance organizations can reach full self-sufficiency in certain settings. Moreover, this can be achieved by institutions serving the very poor as well as those aiming slightly higher. While the concentration of three of the five fully self-sufficient institutions in Indonesia precludes the conclusion at this time that full profitability is routinely possible, the rapid development of Actuar and BancoSol and trends at other institutions suggest that in several years this level may be consistently achieved in a range of settings.

II.C.ii. Trade-off or Complementarity Between Outreach and Financial Viability?

This assessment has sought to examine whether there is a complementary or negative relationship between outreach and financial viability. Table 5 in fact shows a positive connection between scale of outreach and financial self-sufficiency: all the profitable (Level III) institutions have achieved significant scale. The smallest of these, Actuar, with 32,000 clients, is larger than all of the Level II and I programs combined, other than Grameen Bank. The table also shows that programs offering very small loans, such as LPD, BKD, and Actuar can be financially viable. To explore this relationship further, Figure 1 compares average loan size (indicating depth of outreach or poverty level of clients) and return on assets (representing financial viability). Figure 2 depicts the relationship between average loan size as a percent of GNP per capita (a proxy for the relative poverty level of borrowers) and return on assets. The striking feature of these diagrams is their lack of clear pattern. No consistent relationship appears between the variables. Regressions were run in order to examine more precisely the statistical relationship between these and other indicators for outreach and financial performance. None of the outreach variables, either individually or in combination, proved significant as a predictor of rates of return.

Figure 1

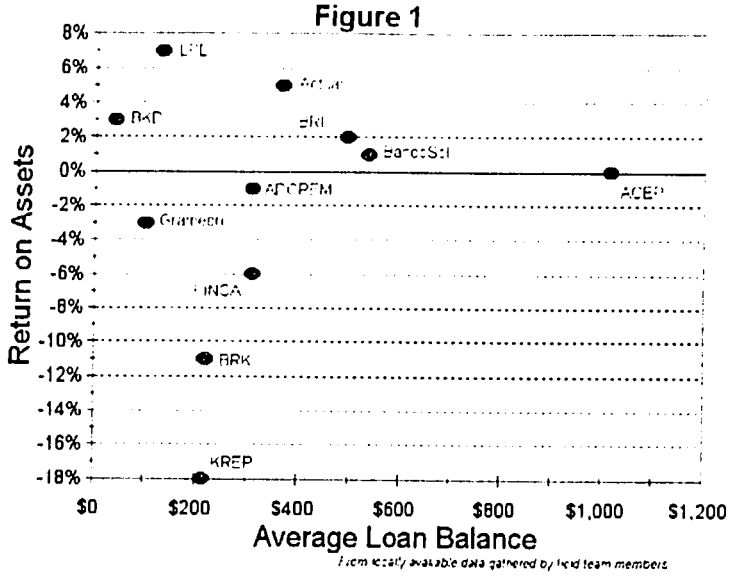
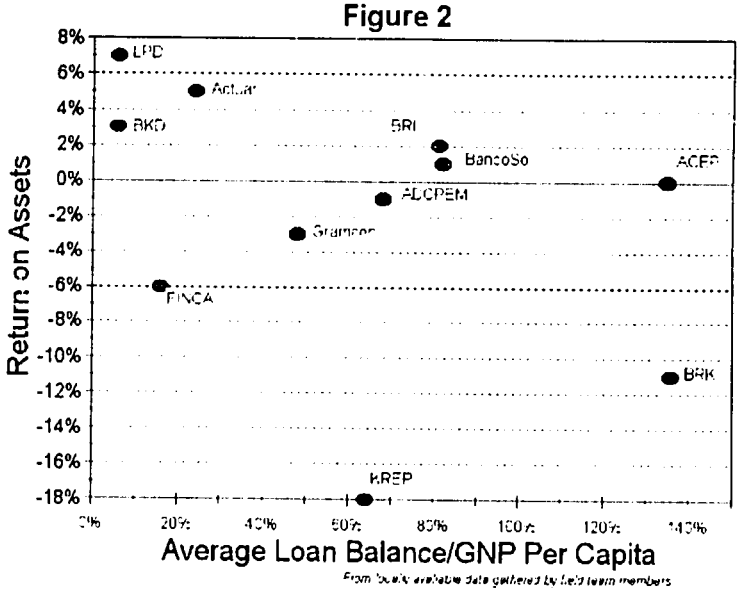


Figure 2



These results show no evidence in this sample of a direct trade off between outreach, either deep or extensive, and financial viability. The two goals are clearly not in opposition to each other.

III.C. What is the Key to Financial Performance?

If financial performance by the very best programs is not a function of outreach, then what are the key determinants of financial viability? Many variables have been suggested, such as density

of the target population (along with ease of access), credit methodology, relationship of local staff salaries to local GNP per capita, and interest rate policies in relation to the macrofinancial environment. In particular, variables relating to the productivity of staff and the cost structure of the institution might be expected to determine differences in profitability.

A range of cost and productivity variables were tested as predictors of retun on assets, such as number and amount of loans per staff member, salaries as a percentage of assets, and administrative costs as a percentage of assets. For each regression, there were eleven observations for the year 1993, one for each program studied.

For only three of the independent variables was the relationship at all statistically significant: the country's rate of inflation, the program's effective real rate of interest charged on loans, and the program's average employee salary relative to the country's GNP per captia. Since the effective real interest rate was more significant than inflation, and since it measures not only the impact of inflation but also the program's interest rate response to inflation, a final multiple regression was run using salary/GNP per capita and real interest rate as the two independent variables. In this regression, both variables were statistically significant, and the regression explained 81 percent of the differences among programs in return on assets.

The study results indicate what seems to be a counterintuitive conclusion. None of the direct unit-cost related variables explained program return on assets in a statistically significant manner. In fact, only one cost-based variable is statistically significant, but even this is not one of the primary unit cost or productivity variables normally examined. Not even the cost of administration as a percent of the loan portfolio is significant. This seems counterintuitive because it is clear that inefficient programs, i.e. those with high operating costs, are less viable than more efficient programs.

These results can be explained in large part by the nature of the sample of institutions analyzed. This analysis is limited to what might be termed frontier programs that have already achieved a strong measure of success in outreach and financial viability. Frontier programs examined in this study, and others like them, have already reduced their unit costs to levels that, when added together as total cost and expressed as a percent of total assets, fall within ranges that can be sustained by financial market spreads. They have found ways to meet the challenge of operational efficiency by adjusting their methodologies to fit their contexts. At these institutions, annual administrative costs as a percent of average loan portfolios outstanding ranged from a low of 9 to a high of 35 percent (see Table 6). Local financial markets can sustain spreads of this magnitude to operate loans of this size with informal clients.

Table 6. Cost and Productivity Measures for Institutions Studied

Program	Non-Fin. costs as percent of loan portfolio */	Salary costs as percent of loan portfolio	Average salary as multiple of GNP per capita	Loans per staff member
ACEP	19	11	6	88
Actuar	21	18	6	90
ADOPEM	35	17	13	74
BancoSol	21	12	5	139
BKD	17	11	2	57
BRI	9	5	4	118
BRK Niger	15	10	21	200
FINCA/CR	13	9	3	270
Grameen Bank	14	9	3	152
K-REP	19	13	18	88
LPD	10	7	1	30

*/ Non-financial costs include all administrative costs, plus depreciation and loan loss provisions.
Locally available data gathered by field team members

Personnel expenses as a percent of average loan portfolios fell into a narrower range, between 5 and 18 percent. Personnel expense is clearly the principal administrative expense and is also a function of the credit methodology chosen, density of the target population, and general level of salaries. While these expenses are between three and five times the levels found in banks, they are only double those found in finance companies that make small installment loans to salaried employees. Moreover, they result in charges to clients well below informal sector alternatives.

This observation further confirms that operational efficiency can be achieved in a variety of settings around the globe and at both the lowest and somewhat higher levels of loan size. Methodologies are available to make operational efficiency a reality for competent institutions willing to work toward that goal. Programs on the frontier have decided to bring their cost structures in line with spreads that are acceptable to clients in the context of local financial markets. No matter what the population density of their local target population or their salary structure, they have adapted their credit technologies in order to reach their financial objectives, as a means of achieving their outreach objectives.

The only cost-related variable that proved statistically significant is the relationship of the program's average annual salary per employee to GNP per capita, expressed as a multiple of GNP per capita. Programs that paid relatively less were more profitable than those that paid more. The programs that paid relatively low multiples of GNP per capita (average salaries from

1 to 3 times GNP) were the BKDs, the LPDs, Grameen, and FINCA, all programs that use local community structures and personnel to staff their operations. These organizations tend to hire field staff directly from the communities they serve, or from similar communities, and to hire on the basis of character and skills necessary to undertake the program's tasks. At the other end of the spectrum, those with the highest multiples (between 13 and 21 times), K-REP, BRK, and ADOPEM, are all currently or recently emerging from donor and project-based NGO structures, and tend to draw from more educated pools of workers.

Two main observations can be made from these findings. First, if programs arise from donor projects where outreach rather than financial viability is the immediate primary goal, then NGOs may lock in a relatively expensive human infrastructure composed of highly educated individuals when in many settings the basic operational functions of the program could be carried out by people with much less formal training. At the same time, programs whose philosophy has been to base operational technologies on community staff have a significant advantage in cost, allowing them to provide very small loans or take very small deposits in a financially viable manner.

This conclusion must be seen in the context of regional variations in levels of education among various economic strata and resulting salary differentials. Some programs may have little alternative but to pay high salary multiples, given local salary structures. Clearly, every program must balance between the need to obtain staff with sufficient skills to perform effectively, and the need to control costs.

II.C.i. Interest Rates and Inflation

Among the sample programs, the effective real rate of interest on loans proved to be the most important single variable for explaining finanicial performance. Effective real rates of interest among these institutions range from -9 to 67 (see Table 7). The program with the lowest rate, K-REP, is also the program with the lowest return on assets (despite being operationally self-sufficient). At the other extreme, Actuar is the second most profitable institution in the sample and has the second highest effective interest rate.

These results suggest that once operational efficiency is achieved through an appropriate methodology, the decision to reach full financial self-sufficiency is largely a choice made by the institution, particularly through its pricing policy. It is not the direct result of context, culture, or target groups, although context may influence whether a given institution is prepared to seek full self-sufficiency. Programs in a variety of settings can choose to be viable. Setting interest rates and fees involves taking into account several factors: operating and funding costs, maintaining low loan delinquency to keep the yield on the portfolio high, assessment of client demand, and inflation. For nearly all of these frontier programs, pricing decisions appear to have been made with cost and client demand clearly in mind. However, policies vary in the way that they respond to inflation.

Table 7. Interest Rates, and Inflation and Return on Assets at Selected Institutions, 1993

Institution	Nominal effective rate, percent (rank)	Estimated current inflation, percent (rank)	Real effective rate, percent (rank)	Return on average assets, percent (rank)
ACEP	20 (9)	8 (8)	14 (9)	0.1 (6)
Actuar	71 (2)	19 (2)	52 (2)	4.9 (2)
ADOPEM	72 (1)	5 (10)	67 (1)	-0.8 (7)
BancoSol	55 (3)	9 (6)	46 (4)	1.0 (5)
BKD	55 (3)	10 (3)	48 (3)	3.2 (3)
BRI	34 (7)	10 (3)	25 (6)	1.8 (4)
BRK Niger	18 (11)	0 (11)	18 (8)	-11.5 (10)
FINCA/CR	32 (8)	9 (6)	23 (7)	-6.3 (9)
Grameen Bank	20 (9)	8 (8)	12 (10)	-3.3 (8)
K-REP	38 (5)	47 (1)	-9 (11)	-18.5 (11)
LPD	36 (6)	10 (3)	27 (5)	7.4 (1)

Locally available data gathered by field team members.

Nowhere is this more clear than in the case of K-REP in Kenya. In its operations, K-REP is as efficient as several other programs selected for this study. Its productivity, measured by the ratio of administrative expenses to total assets, is 10 percent, slightly better than the overall average of 12 percent. Its client to staff ratio is 88, a productivity indicator that also falls close to the overall average of 117. Nonetheless, K-REP currently performs more poorly that any of the other programs when overall financial performance is measured. Notably, its inflation-adjusted return on assets is -18.5 percent.

The key to K-REP's weak financial performance is its inability to adjust its interest rate policies to the currently unfavorable inflationary environment. K-REP is the only institution selected for the study that actually charges a negative real interest rate. In recent years, inflation in Kenya has increased dramatically, while interest rates in the formal financial sector have not. K-REP believes that it would face serious political difficulties disbursing its funds at positive real rates given that the government makes microenterprise loans available at interest rates of 6 to 8 percent while inflation is running at 47 percent for 1993.

Donors inadvertently contribute to this problem. K-REP holds a large share of its assets in savings accounts at banks that yield only 8 percent. These deposits result from large disbursements from donor agencies and are to be on-lent in new branches. A donor viewing this situation might think that K-REP is living off the interest generated by these deposits

without having to incur in any operating expenses. In fact, in the current interest rate setting, K-REP is incurring the far greater cost of having the donation rapidly eroded by inflation. K-REP would have been far better off if it had been able to maintain these funds in dollars until they were actually needed for disbursement.

A fully leveraged bank in this situation would perform far better, since the loss of value would be passed on largely to depositors and other providers of low interest funds, and the bank would probably place most of its equity into in fixed assets such as buildings that are revalued in an inflationary environment. Many banks can thus remain quite profitable in an inflationary environment even as their financial assets shrink in real terms.

Learning such lessons, many programs in Latin America have dealt successfully with inflation by introducing creative fee structures such as charges for client orientation services. Latin America has had a long history of managing in an inflationary environment (although not always successfully), perhaps engendering greater general awareness than in Africa of the ways to adjust. It is useful to contrast K-REP with the case of Actuar in Colombia where inflation was 19 percent at the time of the study and where bank interest rates have been somewhat repressed for many years. Through a creative fee structure, Actuar charges an effective real rate of interest of 52 percent, which allows it to generate a 4.9 percent rate of return on assets. Actuar works with borrowed funds that it on-lends, leveraging its equity, and its net income converts to a 22.5 percent return on equity, a return that compares favorably to many private banks in Colombia. Yet Actuar operates no more efficiently than K-REP. In fact, as a percent of total assets, K-REP spends less on administration (10 percent) than Actuar (15.5 percent).

Whether or not individual programs facing unstable inflationary environments can indeed charge positive real rates of interest varies from situation to situation. However, program experiences in numerous countries have demonstrated that microenterprises can and will pay positive real rates of interest on their loans, even in highly inflationary environments (see Christen, Stearns and Castello, 1991). Programs may have to alter somewhat their credit delivery techniques (e.g., shortening loan terms and increasing the frequency of repayments), but positive real rates of interest can be charged.

These findings have direct implications for practitioners and funders regarding appropriate interest rate policy at microenterprise finance institutions. A key element in the success of microenterprise finance institutions is their ability to develop techniques that are appropriate to their macro-financial environments, inflation in this case, just as they must become expert in dealing with their particular market niches of potential clients.

II.D.i. Importance of the Policy Environment

Table 8 provides some key indicators of two basic aspects of the policy environment identified in Chapter I: (1) the overall level of development of a country and its recent growth, as reflected in GDP per capita and its growth rate; and (2) the ability of a country to achieve macro-financial stability, as reflected in the rate of inflation and changes in the foreign exchange rate. The level of a country's economic development, and especially its recent growth rate, indicate the overall performance of its economic policies.

Table 8. Economic Conditions Facing Selected Institutions

Institution (country)	GDP per capita, 1992 (US$)	Rate of GDP growth	Inflation
ACEP (Senegal)	780	N/A	8 %
Actuar (Colombia)	1,330	3.04%[a]	19 %
ADOPEM (Dominican Republic)	1050	7.88%	5 %
BancoSol (Bolivia)	680	3.44%[a]	9 %
BKD (Indonesia)	670	6.29%[a]	10 %
BRI (Indonesia)	670	6.29%[a]	10 %
BRK (Niger)	280	N/A	0 %
FINCA (Costa Rica)	1,960	6.06%	9 %
Grameen Bank (Bangladesh)	220	4.32%	8 %
K-REP (Kenya)	310	0.44%[a]	47 %
LPD (Indonesia)	670	6.29%[a]	10 %

World Bank, World Development Report, 1994 and locally available data gathered by field team members

As the data indicates, successful microenterprise finance programs with substantial levels of outreach and financial viability exist in a wide variety of policy settings. Two Latin American countries (Colombia and Costa Rica) enjoy relatively high levels of economic development and reasonably good recent growth records, while the other two (Bolivia and the Dominican Republic) show somewhat lower income levels and less consistent growth performance. One Asian country (Indonesia) has achieved a moderate level of economic development based on good growth performance in recent years, but the other (Bangladesh) is among the poorest countries in the world and has shown little growth. None of the African countries has achieved good growth performance in recent years. Two (Niger and Kenya) are very poor, while a third (Senegal) is among the better off African countries. It thus appears that microenterprise finance institutions can achieve substantial outreach and financial viability in a wide variety of overall policy settings, although such success clearly requires adopting appropriate lending techniques for the particular environment.

The table also reveals a variety of inflationary and exchange rate experiences. Moreover, it is important to remember that inflation and exchange rate instability are not only problems in themselves but are also symptomatic of more basic economic policy problems (e.g., a government unable to control its fiscal deficit). Both Asian countries (Indonesia and Bangladesh) have managed to avoid serious inflation and major exchange rate changes, and this has made pricing decisions simpler for microfinance institutions.

The same might also have been said of the three African countries until recently. However, the two members of the French West African Monetary Union (Niger and Senegal) recently

experienced a major exchange rate devaluation and are now experiencing a burst of high inflation. Although this is too recent an event to be reflected in the performance of the microenterprise finance institutions analyzed here , having to live for some time with a significantly overvalued exchange rate may have had an impact of the profitability of their microenterprise clients.

Changes in the foreign exchange rate are often not closely correlated over short periods of time with inflation, so that the ratio of the prices of internationally traded goods to non-traded goods can change dramatically. For example, when governments attempt to restrain the rate of inflation by maintaining the exchange rate unchanged in an inflationary environment, the prices of non-traded goods will rise relatively more rapidly, so that microenterprises in these sectors can be extremely profitable for a period of time, while those producing internationally traded goods are not. This situation will suddenly be completely reversed when the government is finally forced to accept a major devaluation of the exchange rate. Highly inflationary environments and unstable exchange rate regimes may thus force programs to choose not just the most profitable microenterprises at the moment, but to foresee possible major changes among sectors in price relationships. However, this study did not involve analysis at a level that could detect such shifts in clientele.

The Latin American countries included in this study have all experienced substantial macro-financial instability. Until the early 1970s, Costa Rica was a model of stability, but by the early 1980s its inflation rate approached 100 percent per year and its foreign exchange regime became chaotic. Since the mid-1980s, it has achieved greater stability, but never close to its earlier exemplary performance. The Dominican Republic had, until the mid-1980s, engaged in a variety of financially repressive measures that managed to maintain the semblance of macro-financial stability in terms of inflation and exchange rate behavior. However, this appearance dissolved into major inflation and exchange rate instability by the end of the 1980s, but major policy changes at the beginning of the 1990s have re-established macro-financial stability, hopefully on a sounder and more permanent basis. FINCA and ADOPEM have survived these difficulties in relatively good financial health.

Bolivia has had recurrent bouts of major macro-financial instability, culminating in its infamous hyper-inflation of the mid-1980s. Since then, however, it has achieved remarkable stability, especially by prior Bolivian standards, and it is important to note that PRODEM, the precursor of BancoSol, began only after hyperinflation ended.

As discussed above, the experiences of microenterprise finance institutions in Kenya and Colombia illustrate clearly the importance of the ability to adapt to inflation. Actuar, having long experience with significant but fairly stable inflation, has been able to develop devices to charge effective rates of interest high enough to compensate for inflation, while K-REP, with a shorter direct experience with inflation, has not developed such devices.

While it appears that, with experience, institutions can learn to cope with inflation, evidence is lacking that microenterprise finance institutions, like financial institutions in general, can readily develop techniques to deal with true hyper-inflation and all its attendant instabilities.

Another relevant comoponent of the policy environment identified in Chapter I is the extent of financial repression (or liberalization). Because there is such a wide variety of financially repressive measures and, likewise, of financial liberalization programs that may be undertaken to overcome them, the focus in this study is necessarily on a subset of overall repression (or liberalization) policies -- the extent of controls over interest rates and directed credit programs that might impact directly on the outreach and viability of microenterprise finance institutions. Many countries in the study (e.g., Bolivia, Costa Rica, the Dominican Republic and Indonesia) have basically de-controlled interest rates, while others (e.g., Bangladesh, Colombia, Kenya, Niger and Senegal) have not, though Kenya's rates are theoretically no longer controlled. Both K-REP and Grameen Bank face situations in which they feel compelled to hold down interest rates despite not being officially subject to interest rate controls. K-REP felt highly constrained -- by Kenyan Government and donor policies and by its perception of possible negative reactions by its microenterprise clients -- in its ability to adopt the required interest rate policies, perhaps because it did not fully appreciate the urgency of doing so. For Grameen Bank, charging higher interest rates is politically risky. As Bangladesh still retains interest rate ceilings, Grameen must operate with a waiver and feels compelled to keep rates as near those ceilings as it can. Thus, the effects of financial repression may linger after policies are officially reformed.

On the other hand, interest rate controls need not be a serious barrier to microenterprise finance institutions that understand the importance of charging market rates. Many are not in the regulated part of the financial sector, and, for those that are, even law-abiding commercial banks have figured out myriad ways to charge whatever interest rates they wish.

With regard to another aspect of financial repression, directed credit policies, almost every country still has elements of directed and subsidized credit programs. Although microenterprise finance institutions may complain about unfair competition from such programs, they do not generally constitute major threats, because, as is well documented, such programs rarely have strong outreach, particularly among the poor. Thus, in Indonesia, Kenya, Bangladesh, Bolivia, and probably other countries as well, the institutions analyzed here exist side by side with traditional directed credit programs and outperform them in both outreach and viability.

The adequacy of legal systems is another aspect of the policy environment that clearly has major implications for the viability of microenterprise finance institutions. For the ability of lenders, including informal agents as well as formal financial institutions, to create security interest (e.g., mortgages) and to enforce loan contracts, the legal system is obviously crucial, but its importance extends far beyond this. In fact, it has recently been argued that the adequacy of a country's overall legal infrastructure has been a key, but largely unrecognized, element in the success or failure of financial liberalization programs (see Shipton, Vogel and Wellons). The more that microenterprise lenders approximate formal financial institutions, the more important will be the legal infrastructure, as informal techniques to promote loan payment give way to more formal ones. In any case, the more the legal infrastructure promotes a free flow of information about borrower reliability (e.g., through facilitating the creation of credit bureaus), the greater will be the potential for all types of microenterprise lenders to attain viability.

A last observation on the effect of financial repression is that in countries where severe financial repression has retarded the development of the financial sector, the development strategies of

microenterprise finance institutions is affected. For example, in Bolivia and Colombia, with relatively active financial sectors, it is an attractive strategy for institutions to mature to the point that they can access financial markets for funding. In Bangladesh, however, and probably in Senegal and Niger as well, the formal financial sector has relatively little to offer, and institutions must adopt a strategy that is more independent of formal institutions. Interaction with the financial system is discussed at greater length in Chapter III.

In conclusion, the study shows that the most important things government can do to support the growth of microfinance are: 1) to maintain low inflation, or at least stable inflation; and 2) to allow programs to charge the interest rates and fees needed to cover all costs and accommodate inflation. For donors, the most important conclusions are: 1) that microenterprise finance can operate successfully in a wide range of conditions (though it is assumed that hyperinflation is an exception); and 2) the status of financial sector development can affect the growth path of microfinance institutions.

CHAPTER III. ISSUES FACING MICROENTERPRISE FINANCE PROGRAMS

The past several years have witnessed a major change in the way that microenterprise finance programs envision their institutional evolution. Virtually all of the better programs throughout the world are currently in the process of directly accessing local and international financial markets or becoming formal financial intermediaries. Many more fledgling programs have clear examples before them of the paths open to them once they master efficient operations. Prospects are strong for the bulk of programs, which operate well below the frontier, to reach levels of performance like those reviewed here.

One of the forces driving the microfinance field, at both the frontier and pre-frontier levels, is the attempt to expand outreach, and this attempt leads, in turn, to a focus on achieving leverage, or raising funds through private sector sources. The pre-frontier programs seek to mature to the point at which they can qualify to borrow commercially, while the frontier programs are engaged directly in the transformations involved in obtaining leverage, such as becoming a deposit-taking intermediary. This section discusses some of the challenges involved in these processes. Most of the discussion in this chapter goes beyond analysis of the data gathered for the study. Rather, the discussion here attempts to draw out implications for the future.

III.A. Reporting and Performance Standards

One challenge facing microfinance institutions is adherence to high standards of information management and reporting. Accurate and appropriate financial information generated through monitoring and information systems provides the basis for management decision making on a daily basis and is thus crucial for achieving efficient operations. Equally important, the ability to provide financial information according to recognized standards to external sources, donors, commercial lenders, depositors, and supervisory authorities, may well determine whether an institution can gain access to additional sources of funds for expansion. Without such information, banks will not consider an institution creditworthy and regulators will not consider it sufficiently sound for deposit-taking. Good financial reporting is thus a *sine qua non* of leverage and hence of extensive outreach.

The difficulties experienced in the course of this study in obtaining consistent information across institutions demonstrate how far away the microfinance field is from meeting this challenge, even among well-performing programs. Better reporting about outreach is desirable as a reflection of each institution's understanding of its clients and monitoring of its activities, and as a contribution to documenting the achievements of institutions providing microfinance more broadly. Better reporting about financial performance is absolutely critical.

Donors have a special responsibility to ensure that the institutions they support produce information that will contribute to viability and that the donors themselves base funding decisions on accurate information regarding institutional achievements. Donors have had a tendency to require institutions to report information of particular interest to them that is not necessarily useful to internal managers or to other commercial providers of funds. Such practices must change. Donors and practitioners may now be approaching a point at which greater agreement on standard reporting principles is possible. The following observations in this respect are drawn from the experience of this study.

III.A.i. Standards for Financial Reporting

For financial institutions, standards in reporting already exist (generally accepted accounting principles or GAAP), and standard tools of assessment are widely applied (e.g., CAMEL). Microfinance programs should begin conforming to these principles as quickly as possible. The greatest area of weakness found in this study involves portfolio quality: the treatment of arrears, defaults, and loan loss provisions. Non-standard reporting on portfolio quality can seriously distort any picture of financial viability.

Donors should insist that recipients track delinquency in a way that shows the portions of the portfolio at risk (not just late payments), aging of arrears, timely write-offs and annual provisioning. Given the interest in moving programs to higher level of self-sufficiency, donors should also require detailed breakdowns of sources of funds and the costs associated with those funds. Similarly, donors should ask institutions to account for subsidies received, and to adjust for the impact of inflation on their balance sheets.

III.A.ii. Standards for Outreach

For most institutions, reporting on outreach for most institutions is derived from the goals and objectives of that institution, and, given that these goals differ widely, it is not surprising that there is little consistency in the indicators used by various institutions. What is more surprising is the general lack of information.

The most important outreach indicator is the number of currently active clients, i.e., the number of people who currently owe money to the program. Surprisingly, not all of the institutions studied here were able to supply that information. Many frequently reported indicators, such as the number of loans disbursed or the cumulative numbers of clients, are virtually worthless for evaluative and comparative purposes. The number of active borrowers, together with portfolio size, allows average loan size to be calculated, probably the second most important indicator of outreach (though, as noted earlier, the size distribution, not just the average, is needed for a more accurate picture). Analogous measures are also required for savings: number of savings accounts, amount of savings on deposit, and average account balance. Beyond these simple indicators, a minimum of information should be required, and more detailed information, such as employment or income, is best collected through periodic market research surveys rather than routine management information. Programs should, however, develop stronger measures of client response, such as dropouts, delinquency, and market penetration.

III.B. Achieving Operational Efficiency

With all but one of the eleven organizations surveyed achieving operational efficiency, the study shows that efficiency is within the reach of virtually any competent institution that sets out to provide microenterprise finance. The institutions in this study come from a variety of backgrounds, serve a range of clients, and operate under differing conditions, making it clear that the techniques involved in providing microenterprise finance are widely applicable and available. Further, they define what operational efficiency looks like: administrative costs in the range of 10 to 21 percent of the loan portfolio (with the exception of ADOPEM's 36 percent).

These results constitute a challenge to all programs to reach operational efficiency within a reasonable time frame.

Although it concentrates on successful programs, this study does not intend to suggest that becoming efficient is easy. On the contrary, although it should be *possible* in most settings to achieve efficiency, it is *not easy*. There are two clear steps involved in becoming an efficient provider of microfinance services. The first is developing an effective service delivery methodology. The institutions reviewed in this study represent a range of techniques that can be built upon in suitable settings. In every case, however, institutions must adapt proven techniques to their specific situation and clients through field testing and refinement. The second step in reaching efficiency is developing institutional competence in the areas of governance, organizational structure, information management, and staff development (see Rhyne and Rotblatt for further discussion of institutional competence). Once these steps are accomplished, institutions will be poised to enter a phase of significant growth and leverage.

But what is a reasonable time frame? The programs in this sample range in age from several decades to just three years (see Table 1). The youngest program, BRK in Niger, is the only one that has not achieved operational self-sufficiency. Thus, it would appear that a three-year time horizon may be somewhat short, at least in a start-up or experimental setting, such as CARE faces in Niger. Some of the newer programs that have achieved efficiency quickly have long antecedents to draw upon. For example, BancoSol and Actuar have built upon the experience of other ACCION affiliates that pre-dated them, such as ADEMI in the Dominican Republic. Pioneering institutions like Grameen Bank, which took many years to achieve its current national level of outreach, have by their experience shortened the time required for other institutions to develop. In other cases, new microfinance techniques have been adopted by institutions that had already matured using other methodologies (K-REP, BRI, ACEP). While the task of reconfiguring an institution's basic methodology is not to be underestimated, the pre-existing institutional structure may shorten the time required to achieve self-sufficiency.

In determining expectations about achievement of operational efficiency, a reasonable range for a new program would appear to be from roughly three to seven years, with the longer time reserved only for experimental programs with few direct precursors. Programs that have existed longer than this without covering all their operating costs out of revenues may be considered to be either lacking in competence or lacking in the intent to become viable. In examining programs seeking funding, but which have not yet mastered operational efficiency, it is important for donors to select programs that have a clear commitment to and concrete plans for reaching efficiency.

III.C. Increasing Access to Financial Markets

Many microenterprise finance programs have begun to build their lending portfolios on bank loans, guaranteed initially by standby letters of credit, but eventually unsecured, as programs demonstrate their capacity to perform at high quality levels. Some programs, given their success with local banks, are exploring the possibility of accessing local capital markets through issuing bonds and, eventually, even securitizing their loan portfolios.

The advantage that such options present to some programs is allowing them to increase their credit outreach dramatically without also increasing the administrative costs associated with mobilizing savings deposits.

The fact that many microfinance programs are moving in this direction is a highly positive development. It addresses, indirectly, one of the most serious criticisms laid to microenterprise finance advocates: that these programs lack quality control mechanisms. To the extent that an unregulated credit program finances its operations in local capital and credit markets, it subjects itself to market based quality control by its creditors/investors. Creditors/investors require complete and audited financial statements, in addition to certifications by auditors of portfolio quality, demonstrated over a sustained period of time. To support this kind of expansion, ACCION International in Latin America is currently developing a monitoring system to detect potential problems in its microenterprise finance programs before they reach serious levels.

III.D. Becoming Financial Institutions

Most frontier programs not only wish to expand their outreach far beyond what was possible with the limited donor funds available to on-lend, but also wish to provide more complete financial services to their clients. To do this, they must transform themselves from donor-driven programs into full-fledged financial intermediaries, based on locally mobilized savings. This transformation is one that will change virtually every aspect of the institutions involved.

Most programs analyzed for this study are either facing such a transformation presently or have done so in the recent past. In the Latin American region, Bancosol in Bolivia grew out of a highly successful NGO, PRODEM, while Actuar in Colombia recently bought a finance company license and is in the process of transferring its financial operations to this new legal structure. FINCA in Costa Rica and ADOPEM in the Dominican Republic, while not explicitly in the process of institutional transformation, have long considered the possibility of capturing client savings on a large scale and have already accessed local bank loans.

In Africa, ACEP recently received authorization from the Government of Senegal to operate as a licensed financial institution (credit union), while K-REP in Kenya is actively exploring options to create a financial intermediary. BRK in Niger still operates as a donor-dependent institution, but nonetheless intends to seek both self sufficiency and the ability to act as a financial intermediary.

In Asia, all four programs are already financial intermediaries that can accept locally generated deposits from villagers as well as make loans. However, the only program among these that actually began as a deposit driven institution was LPD in Bali. BKD in Eastern Java started as a government credit scheme, which incorporated savings to a lesser extent, but now, almost one hundred years later, is primarily funded from retained earnings and deposits. BRI and Grameen started as both government-sponsored and donor-driven financial intermediaries. The Unit Desa System of BRI unsuccessfully channeled production loans until the mid-1980s when it began a fundamental and eventually highly successful transformation into the unit of BRI most driven by deposits. Grameen has steadily decreased its once total dependence on donor funds by increasing the amount of client deposits in its liabilities structure.

Three issues dominate this transition to deposit based institutions: 1) transformation of a credit-driven institutional culture to one that is deposit based, together with acquisition of the financial skills necessary to manage the intermediation function; 2) addressing the issue of regulation and supervision; and 3) building an equity base for the newly transformed entities. The key to attaining the broad, sector-level outreach envisioned by development practitioners will be the successful navigation of microenterprise finance programs through these issues.

Capital structure is an important challenge for specialized lending institutions that are transforming themselves into formal financial intermediaries. Most microenterprise finance programs are presently well capitalized by normal standards for bank leveraging, so that in most countries this is not an immediate constraint to becoming formal financial intermediaries, unless initial capitalization requirements are so high that even the better microenterprise finance programs cannot meet them. The main capitalization challenge to be faced by institutions in the process of transformation will likely be at a later stage when they may experience difficulties in increasing their capital quickly enough, unless they become significantly more profitable than most are currently.

The fact that most microenterprise finance programs have been capitalized by donor agencies or from other nonprofit sources severely limits subsequent capitalization by "owners" and may require programs to capitalize themselves essentially through retained earnings. Some programs, particularly in Latin America, have been able to do so with remarkable success, but the majority have not been willing or able to generate the profit levels necessary to achieve significant growth in capitalization beyond the limits of donor funding. Many programs have made a conscious decision to favor their microenterprise clients with lower interest rates on the assumption that by such means they are creating greater outreach through greater individual benefits for each microenterprise client served. They have not realized the potential for far greater outreach that is possible through institutional capitalization and, eventually, transformation into leveraged financial intermediaries, as would be possible if they charged higher interest rates to generate the surplus necessary for adequate continuing capitalization.

Microenterprise finance programs that do not yet operate as leveraged financial intermediaries have often proven to be limited in their potential to capitalize themselves through retained earnings. For example, the best performers among the low-leverage microenterprise finance programs analyzed for this study have generated returns on equity of less than 10 percent per year, not nearly enough to support the rates of growth that they are capable of sustaining operationally.

As microenterprise finance programs transform themselves, they may need to incorporate different types of investors who have the potential to increase their equity participation as the institutions grow. To do so will require that these programs demonstrate sustained high levels of financial performance which, if translated into the structure of a for-profit commercial intermediary, would provide attractive returns to investors. The higher the rates of return eventually achieved, the easier it will be for programs to attract capital and to expand their outreach commensurately.

It is not always optimal to be a bank, however, as should be noted in the cases of Indonesia and Colombia where overall monetary restraint falling on regulated banking institutions forced a contraction in credit to microenterprise clients, with the difference in Colombia that the pre-existing NGO could still be used to expand credit.

III. E. Expanding Savings Services

For the field of microenterprise finance as a whole, perhaps the greatest challenge is to expand the provision of savings services to the poor. Extensive research has demonstrated that the poor save even in the absence of financial instruments.[12] They must save if they are to meet the inevitable cash demands generated by family emergencies, major events such as weddings and funerals, and cyclical expenses such as the start of the school year. Vogel's early in Peru, together with Robinson's work with BRI in Indonesia established that poor clients would save in the form of deposits at financial institutions if the instruments they were offered provided greater returns, security and liquidity than their traditional vehicles for in-kind savings. It has already been shown how BRI's voluntary savings programs have enabled it to serve a far larger and lower-income clientele. Effective savings instruments can enhance financial management by poor clients and ultimately increase the productivity of their limited assets. Offering effective financial savings mechanisms to poor families can have more potential outreach than credit.

One of the two major challenges of savings is to transform institutional corporate culture and capabilities to support the technical requirements of offering attractive savings services, as discussed in this section. Equally important, it is necessary to limit permission for capturing savings from the public only to those institutions that are willing and able to meet stringent criteria, as the following section discusses.

Quality savings services for small-scale savers must incorporate four features that Robinson and Vogel have identified as critical. The first feature is already a strong comparative advantage of most microenterprise finance institutions: convenience of location. The most straightforward, but probably least important, of the four is a positive real return. Since microenterprise finance programs can fairly readily pass on their costs of funds to borrowers, offering a competitive interest rate to attract depositors is not difficult. Moreover, in the cost structure of deposit mobilization, the administrative costs of handling small deposits can easily outweigh the financial costs. In fact, some institutions have been deceived by the negligible financial costs of offering checking deposit only to find that the administrative costs were prohibitively high.

The third critical feature for savers is liquidity. Unfortunately, the sensitive nature of liquidity management has been difficult for many specialized lending institutions to master. Lending-only institutions have often become accustomed to a rather lax attitude with respect to liquidity management. If an institution runs a little short of cash, it can simply postpone loan disbursements a week or two with various excuses. Although such actions may hurt a lender's

[12]See, for example, Gadway, et al, 1991; Robinson, 1992a, 1992b, 1994 and 1995; Vogel, 1984, 1990; and Vogel and Burkett, 1986a and 1986b.

image, the effect on morale is nowhere near as serious as what would happen if savers were not immediately satisfied when they came to withdraw their deposits. Any delays in deposit withdrawals can easily lead to a run on deposits and destroy an institution's credibility.

Effective liquidity management requires more sophisticated financial administration than what is normally associated with specialized lending institutions, covering topics such as maturities matching, interest rate risk management, spread analysis, and service pricing. Specialized lending institutions often display weak financial administration skills since these are not generally critical when the only function is loan portfolio management. For example, there is no need for special concern about loan maturities when loans are funded by donor capital. However, microfinance institutions taking savings must protect themselves against the risks inherent in funding relatively long-term loans by short-term deposits. Similarly, such institutions must be able to protect their spreads against adverse interest rate movements on the deposit and lending sides.

The fourth critical feature is to establish that a microfinance institution is a safe place to put savings. Credit unions, for example, have had their credibility seriously damaged over past decades by frequent failures where depositors were not protected. Private finance companies have been involved in questionable activities in many countries, thereby discrediting a broad range of non-bank financial intermediaries. To convince potential depositors to bring in their savings, microenterprise finance institutions must change their images, and this requires fundamental attitude changes among staff. Instead of viewing their fundamental task as one of financing poor microentrepreneurs, they must understand that their fundamental role is to be custodians for the savings of the poor first -- and investors second. Therefore, instead of creating incentive systems focused primarily on disbursing loans, incentives must be placed mainly on generating deposits and administering these funds safely. Loan officers must be supplemented by staff whose orientation is go out and seek new funds. In the LPD system, savings promoters actually outnumber credit officials. Institutions that have provided high quality credit services in particular markets will be positioned to build on that reputation when undertaking the establishment of deposit services. Nevertheless, such a reputation alone is not sufficient. The entire message of the institution must be changed, which can be difficult for an institution that has been successful at a different task.

III.F. Regulation and Supervision

Regulation is a crucial element in the policy environment for all institutions that capture savings from the public. For microenterprise finance institutions the issues are particularly complex, not only in establishing an appropriate set of regulatory norms but also in deciding what types of supervisory agencies might be capable of supervising microenterprise finance institutions effectively. Microenterprise finance advocates have been known to argue vigorously for highly flexible approaches to supervision that would permit microenterprise finance institutions to accept deposits formally on terms much less stringent than those that commercial banks must meet. Such a course should be pursued with great caution and only after understanding clearly the key differences in risk between traditional banks and microenterprise finance institutions.

No country in the world has significant practical experience in the regulation and supervision of intermediaries that engage primarily in microenterprise finance. An agency that wishes to undertake these functions will be limited for empirical guidance largely to regulatory experiences with other types of financial institutions (commercial banks, credit unions, etc.). Microenterprise finance differs from these other types of finance, often in ways that can make microenterprise finance institutions potentially less stable. For example, if a large portion of a bank's loans become uncollectible, the bank will be unable to honor its obligations to depositors. Loan delinquency at good microenterprise finance institutions tends, if anything, to be lower than delinquency at commercial banks, but delinquency in microenterprise finance can be much more volatile, in part because of the typical absence of tangible guarantees and the short term nature of most loans. For a commercial bank that had been running a reasonably low delinquency rate (e.g., below 2 percent), bad management might continue for some time before that rate would balloon to 30 percent. In microenterprise finance programs, in contrast, similar deterioration has been observed in a matter of a few months. On the other hand, the deposit base of an institution deriving its funding from voluntary savings, such as BRI, may be less volatile than that of commercial banks which hold more mobile large deposits.

Another factor suggesting caution is that default by a recognized microenterprise finance institution might have more drastic consequences than default by a bank, especially for other similar institutions. Banks are a familiar part of the financial landscape. Depositors realize that banks may fail from time to time, but ultimately depositors rarely lose their savings and hence continue to use bank services despite an occasional failure. Depositors who might use microenterprise finance intermediaries are, on the other hand, likely to be new to such intermediaries if not to depositing in general. It is thus quite plausible that a failure in such a case could lead depositors to widespread desertion of other microenterprise finance intermediaries.

A third factor suggesting caution is that most microenterprise finance institutions that are currently in the process of transforming themselves into financial intermediaries have only limited capacity to increase their capitalization levels should they find themselves fully leveraged and, simultaneously, incurring operating losses. This may seem ironic given that most microenterprise finance institutions are currently heavily capitalized, but the fact is that most of these institutions have been capitalized by donations from development agencies and not by private investors. If these institutions run into difficulties, they have no clear and solvent owners who can quickly rescue them with additional inputs of capital. Even if a development agency were disposed to rescue an intermediary it had previously established, it would be unlikely to succeed at doing so quickly enough to prevent irreparable harm. On the other hand, there are reasons to believe that donor agencies and NGOs, both local and international, have a continuing interest in the solvency of the particular institutions that they have supported. To some extent, the bankruptcy of a microenterprise finance institution may adversely affect the image of the supporting donors or NGOs. Donors and NGOs may act beforehand to prevent institutions from nearing insolvency.

Another key concern is the limited capacity of financial regulatory agencies in most countries. This situation and the associated problems can be seen clearly in Indonesia where five years ago the government introduced the possibility of establishing local rural banks with a small capital

investment. These banks have proliferated throughout Indonesia and are currently without effective supervision given the minimal resources that the Central Bank of Indonesia has at its disposal for regulatory purposes. In fact, a similar situation arose some years ago with the 5,345 BKDs that were licensed individually by the Central Bank, and the Central Bank eventually turned its supervisory role over to BRI in return for a fee charged to the BKDs.

This constraint has long applied in the credit union movement. With large numbers of individual institutions, an important cause of recurring failures has been the inability to eliminate weak units from the system. Bank supervisory agencies rarely had resources to examine adequately all the commercial banks under their purview and were loathe to expand their responsibilities to other types of intermediaries that they neither understood nor respected. Government agencies responsible for credit unions and credit union federations were commonly even shorter of resources and, originally established as promoters of the movement, had an institutional culture at variance with the disciplined approach required of a supervisory entity. Moreover, the fact that various agencies often had the legal obligation to supervise credit unions appears to have reduced feelings of responsibility on the part of the credit unions themselves to develop serious internal audit capabilities. Entities created or adapted to supervise microenterprise finance intermediaries will face similar challenges.

In spite of the numerous difficulties with the regulation and supervision of microenterprise finance institutions, it is likely that they will be regulated and supervised eventually. In Bolivia, for example, a new legal definition is being established for non-bank financial intermediaries that wish to begin capturing deposits. Although Bancosol has proven that microenterprise finance can be carried out with a regular commercial banking license, the high minimum equity requirements for these bank licenses (about US$5 million) are too high for some of the other promising microfinance programs that also wish to capture savings. Some of the parameters being discussed for licensing in Bolivia are the following:

- A significant minimum equity requirement, probably about 2 million dollars. In Bolivia, this amount of equity does not pose a substantial problem for the six best programs, and these could cover most of the market once they reached their fully leveraged size.

- A track record of three years of successful operations (e.g., maintenance of consistently low loan delinquency rates and the achievement of at least near financial self-sufficiency) and a detailed business plan demonstrating the feasibility of leveraging external funds, assuming full commercial costs for these funds.

- A gradual path toward leverage. Microenterprise finance intermediaries would not initially be allowed full "Basel" leverage (roughly eleven or twelve to one). They would instead be restricted to about five to one for the first two or three years, with subsequent gradual increases toward the Basel limit based on the record and capacity of their owners to increase capital when required.

In some cases these requirements are stricter than those imposed on commercial banks but in general, Bolivian authorities plan to regulate microenterprise finance intermediaries by the same reporting and prudential requirements that are imposed on commercial banks. Bolivia is not

alone. Many countries are currently considering special licensing for microenterprise finance intermediaries.

In summary, there are certain basic rules for the regulation and supervision of deposit-taking institutions that must be applied to microenterprise finance institutions, albeit flexibly. The provision of timely, accurate and pertinent information about financial condition to all potentially interest parties is crucial, along with effective penalties for failing to comply. Moreover, there can no explicit or implicit insurance of deposits without adequate regulation and supervision because of the large losses -- ultimately borne by taxpayers -- that are inevitably incurred under such situations. Beyond these basic rules, the manner of regulation and supervision of microenterprise finance institutions must be flexible enough not to impede what these institutions were designed to achieve -- outreach to clients formerly excluded from adequate financial services. Since numerous microenterprise finance institutions have now demonstrated clearly their viability, supervisors and regulators should not start from the assumption that these institutions cannot function as well as commercial banks because they do not operate with the same procedures as commercial banks. If regulators are not careful they could well force programs to incur significantly higher unit costs in order to be supervised, in direct prejudice of the financial results they might obtain otherwise.

CHAPTER IV: SUMMARY OF FINDINGS AND IMPLICATIONS FOR DONORS

IV.A. Findings

In its analysis of eleven successful microfinance institutions, this assessment has yielded several findings with significant implications for donors and development professionals. This section reviews major findings and points out several important implications.

Outreach. Microenterprise finance institutions can -- and those reviewed here do -- achieve strong outreach along all three basic dimensions: depth (reaching the very poor), extent (significant scale), and service quality. Clients of these institutions are often mainly women. The geographic range of the services is noteworthy, with successful institutions found in both urban and rural settings, and across three continents. The extent to which these services are filling an important gap in the lives of poor communities is demonstrated by rapid growth of demand, despite relatively high interest charges, and by low rates of default among borrowers.

Operational Efficiency. Ten of eleven institutions reviewed here have achieved operational self-sufficiency: they cover administrative expenses out of interest income and client fees. This finding leads to the important generalization that *operational efficiency can be achieved consistently* in microenterprise finance, in a range of settings, and with a variety of clientele. The prerequisites to operational efficiency appear to include the adaptation of an effective service delivery methodology and significant institutional competence in such areas as delinquency control, information management, and staff development.

Full Self-Sufficiency (Profitability). Five institutions reviewed here have achieved full self-sufficiency. Another is on the borderline. These programs generate a return on assets equivalent to returns expected in the private sector, without external subsidies. With only five of eleven passing this hurdle, in only three countries, it is not yet possible to conclude that full profitability can be consistently achieved in all countries. However, given the rapid progress in the field, it is likely that in a few years the ranks of self-sufficient programs will be significantly larger, and the issue of the universality of the emerging model should be revisited.

The Keys to Financial Viability. Among institutions analyzed here, ten of which had already mastered the challenges of operational efficiency, only two variables were significant in determining how profitable the institution was: higher real effective interest rates and lower average salary compared with per capita GDP. Both these factors are substantially within the control of program managers. Thus, given efficient operations, achieving full financial viability depends on institutional commitment to this goal, and willingness to apply that commitment in setting interest rates, controlling costs. and selecting personnel.

Factors Not Directly Correlated with Financial Viability. Contrary to conventional wisdom, the study demonstrated that, among efficient organizations, some variables are not strongly correlated with financial self-sufficiency. The organizations studied here have all found ways to overcome obstacles normally thought to inhibit financial viability.

- *Loan Size*. Among the programs studied, there was no significant correlation between loan size and financial viability. Even among Level III institutions, the full range of loan sizes is represented, from programs serving only the very poor, to those serving a mixture of very poor and moderately poor clients. Several programs show that it is possible to achieve financial viability while serving the very poor.

- *Geographic Setting*. Financially viable institutions and institutions with strong outreach were found in both urban and rural areas and in countries at various levels of development. Thus, the emerging model for microfinance appears to be widely applicable, if sensibly adapted to local circumstances.

- *Economic Setting*. Successful institutions have been developed in countries over a broad range of absolute levels of development, with a range of growth trends, including extremely poor countries and countries where the economy has been stagnant. Programs can even tolerate significant inflation if the institution and general public are sufficiently experienced and have coping strategies. Nevertheless, economic growth and low, or at least stable, inflation, make it easier for microenterprise finance institutions to flourish.

Shortcomings of Microenterprise Finance Institutions. Two apparent shortcomings emerged among this sample of high-performing institutions.

- *Absence of Savings Services*. Despite the importance for low-income people of access to voluntary savings services, only the institutions in Indonesia were providing such services on a broad scale. Several others were planning savings programs or were in the process of implementing them, but few had fully operationalized them. While this demonstrates a gap in service delivery, it is not a gap that can be filled immediately. Rather, it must await the development of new institutional skills and and appropriate approach to permission to capture savings from the public.

- *Lack of Adequate Information*. Few institutions reported financial and outreach data at a sufficiently high standard. Relevant information plays a crucial role both in internal management and in convincing outsiders (donors, lenders, investors, depositors, regulatory authorities) of the soundness of an institution. Inability to provide such information will slow the development of an institution and limit its access to fundi.g.

IV.B. Implications for Donors

These findings suggest that donors and development decision makers should take action in certain directions. With the right model for self-sufficient financing and effective outreach, the findings suggest that microenterprise finance institutions can grow to the point where they address the demand for financial services in poor communities around the world. If such a broad development opportunity is truly within reach, it is important to make the effort to grasp it.

The Bottom Line: Scale and Leverage. Decision makers should have a clear understanding of the performance standards that organizations examined here have achieved, and they should use those standards in making funding and policy decisions. These standards also lead institutions toward the ability to gain access to funds from non-donor sources, thus leveraging donor inputs.

- This strategy speaks particularly to those who are concerned with reaching the very poor. The study shows that organizations can attain scale and leverage while including the very poor in their client group.

- Donors should craft their support in ways that foster financial independence. In essence, they should view their role as supporting the commercialization of this field and themselves as start-up investors.

Elements of Donor Policy. Assessment findings suggest that donors need to pay close attention to several key issues as they formulate support efforts in microfinance.

- *Commitment to Efficiency.* If operational efficiency can be achieved in most parts of the world and in a range of geographical and economic settings, donors should have clear expectations that any microfinance program they support will reach operational efficiency in a reasonable time period. They should select organizations for support that have a credible commitment to reaching operational efficiency.

- *Interest Rate Policy.* Donors should insist that organizations they support price their services at a level that supports financial viability. In particular, programs must adjust adequately to the potentially erosive effects of inflation.

- *Reporting Standards.* Donors should insist that supported organizations report on their performance according to generally understood and accepted standards in a way that makes subsidies transparent. They should be prepared to offer technical assistance to organizations to develop the capacity to do so.

- *Frontier Issues.* Donors have an important facilitating role in helping top-performing institutions make the transition to full independence. Among the interventions that may be called for are policy dialogue with governments regarding supervisory standards for microfinance, technical support to transforming institutions and to those who wish to develop savings services, and support to the process of identifying and securing equity investors.

As more microenterprise finance programs cross the hurdles of operational efficiency and then full profitability, with strategically applied external support, they can begin to reach tens of millions of poor families with high quality financial services. In so doing they help those families lead more secure, empowered, and healthy lives and to provide their children with better economic opportunities. Enlarging opportunities is the ultimate purpose of microenterprise finance.

APPENDIX A: Methodology for Financial Adjustments

In order to examine more fully the current state of the art in microenterprise finance and the relationship between outreach and financial viability, analists visited eleven of the best programs throughout the world. They collected data on outreach and financial performance for each program over the past five years.

The team had great difficulty generating and standardizing the outreach and financial data from most of the individual programs. In fact, in most cases the data that were available had been prepared primarily to suit donor requirements rather than internal management needs. This was particularly true with respect to the outreach information. There was very little consistency in the type and frequency of information gathered on outreach, making the generation of comparative tables difficult.

On the financial side, the information available from most programs was highly aggregated with little detail related to the nature of the accounting adjustments employed or the policies underlying key accounts such as the loan loss provision. In most cases, the team was able to gather this type of information on visits to the programs and adjust the audited financial statements for presentation in this study.

Externally audited financial statements are frequently imprecise when it comes to describing in the attached notes the composition of certain fundamental accounts. Although from one program to another external auditors apply standard accounting principles, these principles do not include standard practices for things like inflation accounting, loan writeoffs, and accrual vs. cash systems. Although this level of standardization is usually imposed (on regulated institutions) by the bank examiners in any one country, NGOs, who administer the majority of microfinance programs, are generally exempt from these requirements.

CONSTRUCTING THE FINANCIAL STATEMENTS

The first step in constructing comparative financial statements for each of the programs was to express in a common set of accounts the information from each of the programs' audited statements. The following describes the common set of accounts utilized and the concepts that were used for each.

Balance sheet accounts:

Cash on hand -Cash on hand and in banks that does not for practical purposes earn income

Deposits in Banks - Assets placed in income generating deposits within the financial sector. Special care was taken to note any particular conditions of these deposits: use as collateral guarantees, legal requirements, reserves, etc. Conceptually, it is important to distinguish between 'excess' liquidity and assets of this type which the institution is not free to lend directly.

Loans to Clients - Assets which have been placed with clients and are not experiencing late payment difficulties.

Overdue Loans -	Assets which have been placed with clients and are experiencing late payment difficulties. The consultants used 90 days as the guideline for considering a loan payment late and classifying the outstanding loan balance as Overdue whenever that data was available. When the criteria were different, the consultant made a special note.
Loan Loss Provision-	This account, expressed as a negative balance, should reflect the historical bad debt experience and real risk profile of the portfolio. If the program has not made this provision on analytically solid or consistent grounds, the consultant was asked to calculate what that provision should be as a seperate excercise by relating the historical writeoff percent to the historical late payment record..
Accounts Receivable -	Other accounts receivable from employees, clients, or other sources. If loan payments have been made with post dated checks they were included here.
Accrued Interest	Interest earned but not yet received. Interest accrued on loans overdue more than 90 days was to be backed out of this account if programs had not already done so. This was not necessary as most programs do not use accrual accounting but rather cash based accounting.
Other Current Assets -	Account containing any other unclassified current assets.
Fixed Assets	Land, buildings, equipment. The consultant had to be careful to understand the basis for valuing these assets. They were to be presented revalued for inflation and depreciated for use. This value should not vary tremendously, in principle, from a generally understood market value. If they do vary substantially the consultant should put a note and suggest the relevant market value. Given the time constraints and the relative unimportance of fixed assets in the balance sheets of these types of programs, this adjustment was frequently not done. This does not alter in any significant way the conclusions of the study.
Demand Deposits	Demand deposits from clients such as checking and passbook savings. These accounts were presented seperately in the financial statements according to type. The consultant described each instrument in accompanying notes, including interes rates paid, conditions for deposits (limited number of withdrawals, minimum balances, etc) and client group to which the instrument is directed.
Time Deposits	Time deposits from clients such as CDs. The consultant described these accounts in notes in a similar fashion as the demand

	deposits.
Short Term Loans	Loans from other financial institutions. Were classified by type and described in detail in accompanying notes which contain information about the interest paid, conditions, and sources of these funds. Additionally, the portion of long term loans which are due during the following 12 months is frequently included here.
Accounts Payables -	Outstanding obligations with service providers and others.
Other Current Liabilities -	Non-classified liabilities of less than 12 months duration.
Long term loans	Loans from other financial institutions whose term is longer than 12 months and whose conditions are at or near market values. These loans were described in the same type of detail as the short term loans in terms of conditions, interest and of the financial costs, and source of funds.
Concessionary funds -	Loans from financial or other institutions whose conditions were considerably more favorable than the market values. These loans were described in detail.
Other Liabilities	Non-classified liabilities.
Reserves	Reserves should be individualized by the consultant and should contain reserves at least for: exchange rate exposure should there be any, employee indemnization should this be required, and any other clearly identifiable and quantifiable risks other than general business risk. These reserves are identified seperately, expensed through the profit and loss statement, and described in accompanying notes.
Inflation Adjustment -	The cost of inflation applied to equity account balances at the close of the prior annual period. This inflation adjustment is also reflected as an expense on the income statement.
Subsidy Adjustment -	The consultants were asked to estimate what the market price would be for funds which reached the program at a significantly subsidized rate and incorporate as both as expense and a capital account the difference between the estimated market price and the real financial costs paid by the program.
Net Profit	Net profit or accumulation from the current period
Accumulated earnings -	Accumulated net profits from prior periods.

Paid in Equity	Original capital base plus additions to capital from sources other than net profits.

Profit and Loss Statements included at least the following accounts:

Interest Income	Income generated by loans to clients on an accrued basis with overdue interest backed out after 90 days. In many cases the programs account for interest income on a cash basis and the consultants did not calculate the accrued interest. This was because most of these programs use weekly, bi-weekly and monthly payments so the one time addition to annual income from that portion of income not accounted for is not particularly significant to the overall results.
Investment Income -	Income derived from deposits in financial institutions.
Fee income	Income generated from fees charged to clients for services provided. In those instances when the fee income is for services other than loans, these services were described by the consultant in notes. Included in this description was an indication of whether participation in these services is obligatory on the part of loan or savings clients. Fee income was to be seperated between fees on savings services and those on loan services but this was not usually able to be done by the consultants.
Other income	This account reflects income from donations or other non-operational activities.
Salaries	This account reflects all personnel related expenses
Rent/Depreciation	This account relects the infrastructure costs
Utilities	Electricity, gas, water, etc.
Administration	Materials, transport, fees paid, communications
Public relations	Publicity, public relations
Other oper. expenses -	Non-classified operating expenses
Financial costs	Interest and fees paid to financial institutions.
Loan loss prov, other res -	This is the expense counterpart of any of the reserves created to anticipate future expenses.

Inflation adjust	This is the expense counterpart to the capital account where the 'cost of inflation' in the capital accounts is registered.
Subsidy adjustment -	This is the expense counterpart to the capital account which represents what the institution would have had to pay were it to have financed its assets out of funds generated at market rates.
Other expenses	Non-classified other expenses. These were explained by the consultant in a note.

ADJUSTMENTS TO THE AUDITED FINANCIAL STATEMENTS

The purpose of the adjustments done by the consultants to the program's audited financial statements was to provide a level playing field for all programs in order to comment on the financial viability of providing financial services to the poor. Given the wide variability of the accounting practices which underlie the externally audited financial statements, the different methodologies employed to reach significantly divergent target markets in countries with varying policy contexts, and the fact the most of the programs have received subsidies of one sort or another, these adjustments must be undertaken.

In order to do these adjustments, the consultants had to do specific analisis independent of the audited statements since in most cases the information provided for external use is highly aggregated, frequently for the precise purposes of presenting financial results in a most favorable light. For these purposes they reviewed the following information on their site visits:

Audited financial statements with all accompanying notes, with clarification of key concepts such as whether it is cash or accrual accounting.

Detailed cost information which provided a monthly or quarterly breakdown by principal accounts.

Portfolio quality tables showing the outstanding balances affected by delinquency, aged in some manner

Bad debt write-offs

Bad debt provisioning policies

Institutional policies related to the creation of all other reserves and provisions

Liabilities structure, terms and conditions of each type of liability

Monthly porfolio statistics including number of loans outstanding, total portfolio, types of loans, interest rates on different types of loans, average loan size, and late payments

Description of the credit methodology utilized on an operational level

Description of infrastructure utilized on an operational level, especially branch office system, but including the information systems, transportation, etc. (reference to context in which program operates which impose certain operational structures)

Exchange rate (monthly)

Inflation rate and/or index (monthly)

Market interest rates for savings and for loans (monthly)

Three major adjustments were made to the audited financial information provided by each of the participating programs in order to draw conclusions across the sample. Thus all of the programs were placed on a level playing field, as if they had all been applying the same accounting policies throughout the past five years.

The first major area of adjustment was to ensure that programs were provisioning and writing off bad debt in a consistent manner. The criteria adopted for this study was that the loan portfolio on the balance sheet should reflect both the on-time loans and the overdue loans. Overdue loans should accurately reflect the outstanding balance of loans with payments overdue more than 90 days. Overdue balances (more than 90 days) were not always available and so sometimes another definition was permitted since this does not necessarily distort greatly the current portfolio situation if loan terms are very short.

Additionally, the balance sheet was to reflect a loan loss provision that reflects the historical bad debt experience and the current risk profile of the portfolio. Usually this provision is based on a separate off-the-books analysis. The team also tried to reconstruct the bad debt writeoff history as part of this exercise to check for consistency. The team used the rule that a loan that has been overdue for 360 days should be written off in its entirety.

The second major area of adjustment was to take into account the effect of inflation on programs. Programs who operate in highly inflationary environments and that do not take this variable into consideration, suffer severely as the value of their financial assets shrinks in real terms. This involved two different analysis:

Revaluation of Assets - Non-monetary assets were revalued to the extent of annual inflation and then depreciated. Liabilities denominated in foreign currencies were also revalued to the extent the relative exchange rates changed.

Inflation Adjustment of Equity - Under the assumption that investors/donors should be entitled to maintain the real value of their investment over time, the cost of inflation is applied to the equity account balances which were maintained at the close of the prior annual period. To generate this value the consultant multiplied the prior year's closing capital balance by the current year's inflation rate. This adjustment is reflected in a capital account called "inflation adjustment" and as an expense account on the income

statement.

The third area of adjustment, undertaken only when necessary, was to account for the effect of subsidies; either direct in terms of donation income or indirect in terms of lower financial costs due to concessionary funding. The purpose of this is to put all programs on equal ground analytically, as if they were all operating with commercially available, third party funds. In fact some programs do operate with exclusively commercial sources of funds while others operate with exclusively donated or concessionary funds. If programs operate exclusively with donated funds, then the "cost of inflation" on those funds is considered in the inflation adjustment already discussed since these funds appear on the balance sheet as equity.

Concessionary loans to the program were treated with a different opportunity cost. It was considered that these funds should carry an interest rate equal at least to the short term time deposit rate paid in a local economy. This adjustment, called the "subsidy adjustment" in the individual program financial reports, is calculated as the amount the program would have had to pay for these funds had it gone into the local financial markets. It appears both as an expense in the profit and loss statement and as an accumulated capital account on the balance sheet.

None of these adjustments affect the overall totals for the balance sheets of the programs. Rather, they signify a rearrangement of the capital accounts, reflecting lower real retained earnings and generating new capital accounts reflecting the increase in equity necessary to maintain the real value of the capital and, compensate for the effect of subsidized cost of funds.

These three adjustments fundamentally affect the profit and loss statements of programs.

What does change dramatically as a result of these adjustments are the traditional measures of profitability. These, which normally have been supplied to the public in nominal, unadjusted terms, we express in real and adjusted terms. The net overall effect, of course, is to lower these profitability levels; in some cases, considerably. Nominal profits are lowered, becoming in essence profits in real terms under the assumption that the program were to operate entirely as a commercial enterprise.

This provides us with a much more realistic picture of exactly where programs are in terms of financial sustainability in a way that is readily understood beyond the confines of the unique accounting principals favored by microfinance institutions and other non-profit entities. The reader should be careful not to assume that these adjustments reflect a bias on the part of the authors that these services should be provided on a commercial basis; but rather that this analytical device helps us to understand how close programs are to operating on that basis, given our outreach goals.

PRESENTATION OF THE ADJUSTED FINANCIAL STATEMENTS

The final adjustments that were done to the nominal local currency data in order to more fully appreciate the real evolution of programs and facilitate the drawing of conclusions across the entire sample were first, to express these financial results in constant 1993 local currency terms.

Subsequently, these constant 1993 local currency values were expressed in terms of 1993 dollars. These constant currency adjustments do not affect profitability or any other key ratios but only year to year growth ratios which instead of being expressed in nominal terms, are expressed in real terms. The conversion to 1993 dollars affects no ratios. Neither nominal nor constant local currency values for prior periods were transformed on the basis of prior period exchange rates because of the distortions that frequently exist in local dollar markets that alter the long run relationship between the rate of currency devaluation and the inflation rate.

GENERAL COMMENTS

We have attempted to make clear what adjustments we have made to the financial statements. In some cases, we were forced to make reasonable assumptions or classify accounts in somewhat less exact ways in order to fit them into the general framework necessary for the study to draw cross-program conclusions.

As a result, the financial statement data presented should be regarded as REPRESENTATIVE of the way different programs would look if the same criteria were applied across the board, especially with repect to loan losses and provisions and adjustments for the effects of inflation and concessionary sources of funds. They should be regarded as REPRESENTATIVE because in some cases the quality of information available in programs was supplied on too aggregate a level that the team was forced to make general estimates rather than precise calculations.

As a result, the readers should excercise extreme caution when attempting comparisons between individual programs on the basis of the results presented here. The results presented in this summary document represent financial performance for only one year, 1993. A review of each of these programs would clearly indicate that these results change dramatically for each institution as a consequence internal decisions regarding adjustments in salary levels, hiring of new staff previous to an important expansion phase, interest rate policy changes, institutional type transformation and other vital structural variables. Virtually none of these programs operates in a steady state equilibrium; but rather all can be characterized by very high rates of growth. Thus it is critical for the reader to focus on the collective outreach and financial performance of the group of institutions selected rather than making individual, and inevitably, not particularly accurate or significant comparisons between programs.

Additionally, these results represent the fr ntier of our current microfinance technology within widely differing cultural, economic, dem aphic contexts. Results which on the surface appear to be better in one context (for example a higher rate of return on assets) may be completely non-replicable in a different context due to factors that make it more expensive to operate. All programs may well face important opportunities to improve both their outreach and financial performance, in effect moving their production possibility frontier outward.

APPENDIX B:

SUMMARY DATA 1993	BKDs	LPDs	GRAMEEN	KREP	BRK	ADOPEM	FINCA	ACTUAR	BRI	BANCOSOL	ACEP
COUNTRY DATA											
POPULATION (millions)	14.8	2 8	108.0	25 0	8.5	7 7	3.2	32 8	181.3	7 3	7.9
GNP PER CAPITA	$670	$670	$220	$310	$280	$1,050	$1,960	$1,330	$670	$680	$780
CURRENT INFLATION RATE	9.5%	9 5%	7.8%	47 1%	0.4%	5 3%	9.0%	19.2%	9.5%	9.3%	6.0%
BASIC INSTITUTIONAL PROFILE											
NUMBER OF BRANCH OFFICES	5,345	651	1,030	6	14	6	1	13	3,267	21	19
NUMBER OF EMPLOYEES	16,035	4,913	10,452	60	34	47	19	355	16,067	335	31
TOTAL ASSETS	$62,591,331	$25,597,601	$238,697,436	$1,946,000	$1,586,000	$1,799,000	$1,708,853	$15,681,210	$2,288,743,000	$34,100,296	$3,087,013
AVERAGE ANNUAL GROWTH TOTAL ASSETS	2%	34%	30%	116%	69%	99%	39%	131%	15%	190%	25%
CLIENTS - WOMEN	50%	40%	94%	60%	45%	100%	26%	50%	24%	71%	20%
PROFILE OF CREDIT SERVICE (*)											
TOTAL VALUE OF ALL LOANS OUTSTANDING	$34,196,927	$18,807,632	$159,480,769	$1,149,000	$1,500,000	$1,079,000	$1,586,656	$11,732,836	$937,626,000	$24,830,644	$2,143,184
NUMBER OF LOAN CLIENTS	907,451	145,183	1,586,710	5,303	6,787	3,500	5,121	32,022	1,897,265	46,428	2,109
AVERAGE OUTSTANDING BALANCE	$38	$130	$101	$217	$221	$308	$310	$366	$494	$535	$1,016
ANNUAL GROWTH RATE, LOAN PORTFOLIO	-0%	25%	35%	213%	65%	92%	36%	134%	8%	182%	41%
AVERAGE LOAN TERM	4 mos.	10 mos	12 mos	12 mos	10-13 mos	4 & 12 mos	12 mos.	5-12 mos	24 mos.	4-12 mo	12 mos.
EFFECTIVE RATE OF INTEREST	55%	36%	20%	38%	18%	72%	32%	71%	34%	55%	20%
EFFECTIVE REAL RATE OF INTEREST	46%	27%	12%	-9%	18%	67%	23%	52%	25%	46%	14%
CREDIT METHODOLOGY - Groups	0%	0%	100%	100%	80%	40%	100%	90%	0%	100%	2%
CREDIT METHODOLOGY - Individual Loans	100%	100%	0%	0%	20%	60%	0%	10%	100%	0%	98%
AVERAGE LOAN BALANCE/GNP PER CAPITA	6%	8%	48%	64%	136%	68%	16%	24%	81%	82%	135%
CAMEL ANALYSIS - CAPITAL ADEQUACY (*)											
EQUITY AS PERCENT OF TOTAL ASSETS	82%	20%	31%	89%	100%	18%	29%	16%	5%	16%	93%
CAMEL ANALYSIS - ASSET QUALITY (*)											
DELINQUENCY - Balance loans overdue > 90 days	10.3%	3.9%	2.0%	2 3%	20.0%	4.0%	1.7%	1 3%	6.5%	0.0%	3 0%
EFFECTIVE YIELD ON LOAN PORTFOLIO	37%	36%	20%	22%	9%	49%	24%	50%	28%	45%	27%
CAMEL ANALYSIS - STAFF MANAGEMENT AND PERFORMANCE (*)											
NUMBER LOANS/TOTAL STAFF	57	30	152	88	200	74	270	90	118	139	68
SALARIES/TOTAL ADMINISTRATIVE EXPENSE	69%	65%	64%	68%	69%	48%	65%	75%	53%	60%	55%
SALARIES/AVERAGE PORTFOLIO	11.5%	6 6%	9.3%	12 9%	10.1%	16 8%	8.7%	16 2%	4.5%	12 5%	10 6%
SALARIES/AVERAGE TOTAL ASSETS	6.3%	5 0%	6.1%	6 9%	9.7%	10 2%	8.2%	12 0%	1.9%	9 2%	6.9%
AVERAGE SALARY FIELDWORKER	$1,100	$1,150	$687	$6,000	$3,354	$5,750	$6,192	$8,573	$2,567	$3,300	$4,367
AS MULTIPLE OF GNP PER CAPITA	1.8	0 7	3.3	17 6	20.6	12 7	3.3	5 5	4.2	5 1	5.8
CAMEL ANALYSIS - EFFICIENCY AND PROFITABILITY (*)											
OPERATIONAL SELF-SUFFICIENCY (**)	197%	148%	105%	106%	44%	94%	98%	124%	113%	107%	142%
FINANCIAL SELF-SUFFICIENCY (***)	118%	137%	79%	38%	43%	89%	75%	104%	110%	103%	100%
ADJUSTED RETURN ON AVERAGE TOTAL ASSET	3.2%	7.4%	-3.3%	-18 5%	-11.5%	-0 8%	-6.3%	4 9%	1.6%	1.0%	0.1%
ADJUSTED RETURN ON EQUITY	3.8%	32 7%	-9.7%	-15 2%	-9.1%	-3 3%	-18.7%	22 5%	31.0%	4 3%	0.1%
ADMIN. EXPENSE/AVERAGE LOAN PORTFOLIO	16.7%	10 1%	14.5%	19 0%	14.8%	35 1%	13 4%	21 5%	8.5%	21.0%	19.1%
ADMIN. EXPENSE/AVERAGE TOTAL ASSETS	9.2%	7.7%	9.5%	10 1%	14.1%	21 3%	12.5%	16 0%	3.6%	15.4%	12.5%

(*) on basis of 1993 dollar, adjusted accounts (**) Operational selfsufficiency - Operating Income/Operating Expense (***) Financial selfsufficiency - Operating Income/Total Adjusted Cost

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