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Financial Services for the Poor: IFAD's Perspective

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Financial Services for the Poor: IFAD's Perspective

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1. Introduction

1.1. IFAD's Specificity as a Multilateral Financial Institution

1. The International Fund for Agricultural Development (IFAD) plays a unique role in the U.N. system. Since its inception, the Fund has focused on the poorest of the rural population in low-income countries[2]. As a Multilateral Financial Institution, IFAD has developed its specificity by initiating or accelerating development in the most deprived rural areas of developing countries. Since small farmers and the landless constitute the primary entry point for interventions[3], IFAD projects are usually directed specifically towards this target-group.

2. The rural poverty alleviation strategy of IFAD is based on a twofold approach: (a) the most disadvantaged groups of the rural population are the direct target of project interventions, which in the long run aim at (b) integrating the rural poor into the mainstream of economic development and ensuring adequate levels of household food security.

1.2. The Role of Financial Services in IFAD's Lending Operations

3. The provision of financial services has assumed a pivotal role in IFAD project activities. IFAD supported savings and credit services are based on the conviction that the rural poor can be bankable. Properly managed credit to IFAD target group beneficiaries can contribute to their economic and social advancement. Demand for deposit services by impoverished households arises largely from the cyclical and uneven flow of income from agricultural production. Liquidity immediately after the harvest creates a demand for deposit facilities that ensure the protection of money, while at the same time securing incremental income from interest earnings.

4. Credit components amount to about a third of total project costs in the overall IFAD portfolio[4], constituting the single most important project component for IFAD investments. Moreover, since the inception of the Fund, 49 projects out

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[1] The views expressed in this paper are those of the author only and should not be attributed to IFAD.

[2] Agreement Establishing IFAD, Article 7, Section 1 (d); 1977

[3] Lending Policies and Criteria, IFAD, p.2; 1978

[4] 31.2 per cent in 1985 - 1992; 35.9 per cent in 1993

of a total of 337[5] were mainly focused on rural credit. Deposit facilities for the target population are promoted together with the provision of credit.

5. This paper draws on the Fund's experience in promoting financial services for the poor. In chapter 2, some weaknesses that have emerged in the conventional support strategies are analyzed. Some evolving experiences of IFAD in the provision of financial services are then outlined, followed in chapter 3 by the identification and description of six main building blocks for successful project intervention in the areas of deposit and credit promotion. A more detailed study on the emerging approach of "Customerizing Financial Services" (CFS) which further elaborates on the findings of this paper is available from IFAD[6]. Through the CFS approach, IFAD seeks to reconcile two conflicting perspectives in conventional financial development strategies: (a) the perspective of the financial intermediary to whom the IFAD-specific target group represents a major challenge because of perceived cost and risk implications of banking with the poor; and (b) the perspective of the resource-poor IFAD project household with its specific deposit and credit service requirements. A basic test of the quality of a project is the extent to which it succeeds in harmonizing the objectives of both the PFIs (Participating Financial Institutions) and the project beneficiaries.

2. The Challenge of Providing Financial Services to the Poor: Problems and Emerging Weaknesses

2.1. Problem Definition and Analysis

6. As a first step, weaknesses in conventional project design need to be identified and assessed which impede the satisfactory performance of IFAD investments in savings and credit operations. Problems in externally promoting financial services can broadly be defined as (a) offering services which do not match the quality or quantity requirements among the target group, and (b) a service structure which entails costs and risks for PFIs that make sustainability after project completion unlikely.

2.2. Weaknesses in Conventional Strategies: Household Level

7. Understanding the opportunities and constraints for development at the level which counts for the beneficiary, the household level, is a sine qua non for successful project design. Following is a short list of critical issues at the household level which can impede a demand-oriented design of viable savings and credit components in IFAD projects:

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[5] includes Regular Programme and Special Programme for Africa

[6] Ph.K.H. Bechtel, R. Zander: Providing Financial Services to the Rural Poor: IFAD's Experience, Challenges and Evolving Approaches, IFAD Staff Working Paper Series No. 16, 1994.

Overemphasis on Credit

8. Resource limitations and liquidity constraints of low income households do not necessarily translate into an effective demand for project-supported credit. Investments must generate an adequate, risk-adjusted financial rate of return to allow for a credit intervention. Professional skills and management capacities of credit clients may be lacking. Marketing opportunities might not be available. In other cases, production factors other than capital are limiting economic advancement: a line of credit will not automatically lead to benefits, unless access to inputs, land and appropriate technology is ensured.

Inappropriate Assessment of Risk-bearing Capacity

9. Project lending operations often result in low repayment because of deficient assessments of the creditworthiness of loan applicants. The success or failure of a loan is largely determined by a competent initial appraisal of the debt repayment potential of the borrower. Lack of professional analysis of the extent to which a resource poor household can service loan repayments leads to over-ambitious credit programmes with consequently low rates of repayment.

No Distinction Between Original and Project-Induced Credit Demand

10. Usually, donors do not differentiate between two separate demand structures for rural credit. Original demand for credit refers to demand for loans in a without-project situation. Rural households with very small incomes reduce their effective credit demand to basic investment and consumption requirements. Since the rural poor resort primarily to the informal segment of rural financial markets with effective mechanisms for loan enforcement, small borrowers assess their own repayment capacity cautiously and commit themselves fully to servicing credit installments. - Development interventions proposed by a project imply either an expansion of activities already undertaken or the uptake of new operations with uncertainties regarding the level of incremental income generation. A borrower in a project context may not necessarily show the same commitment to a project-financed activity that he would for an investment planned and appraised on his own initiative. Project-induced credit demand at household level may therefore be accompanied by a distinctly higher risk outlay and less commitment to repaying as schedul d.

Inappropriately Targeted Interventions Leave Households Worse-off than in the Without Project Situation

11. As a consequence of deficient credit strategies at household level, a resource-poor borrower who just made do with his scarce existing resources prior to a project, may be left indebted upon project completion. This may lead to a need for continued external support, distorted relations between the client and the financial institution and a deterioration of the borrower's asset base, if the credit customer attempts to service loan repayments regardless of the level of incremental income generation.

12. The following lessons can be learned with regard to weaknesses in conventional planning of savings and credit services at household level: the analysis at household level must establish first and foremost whether there is an effective demand for the credit and deposit services to be offered under the project umbrella. Secondly, an inadequate assessment of the risk-bearing capacity, overemphasis on credit and unrealistic projections of effective demand for project-induced financial services, without an understanding of the socio-economic environment and the specific constraints of the beneficiary household, constitute the main weaknesses of project design at the household level.

2.3. Weaknesses in Conventional Strategies: Institutional Level

13. Once the demand for financial services at household level is firmly established, careful identification of a suitable servicing partner becomes the second imperative for project design. The Fund selects Participating Financial Institutions (PFIs) flexibly, the scale ranging from small single-purpose savings and credit cooperatives to large private commercial banks with a presence in the project area. The selection of PFIs is usually based on the following main criteria:

(a) the service capacity of the PFI to reach out to IFAD's specific target group with grass roots oriented deposit and credit services;

(b) commitment on the part of the PFI to channel project financial services to beneficiaries with a firm understanding that activities initially supported by IFAD will eventually be integrated into the ordinary business structure of the PFI;

(c) a record of past performance which shows that the PFI operates as a prudently managed, viable financial institution with adequate managerial capacity also at the branch level.

14. During project design a clear distinction and coverage of the two separate stages of identifying and appraising PFIs is indispensable. Omitting in the first stage a thorough appraisal of the institutional performance in a without-project situation may seriously handicap project delivery. As a second step, identified PFIs would need to be technically and financially appraised with respect to the feasibility of project-required on-lending, savings mobilization and risk management arrangements.

15. Common weaknesses in the institutional service structure in the without project situation include:

Negligence of Cost and Risk Dimensions

16. Managing the costs and risks of savings and credit operations constitutes the main objective of prudent banking. Prior to introducing customer outreach programmes to the lower income segments of the rural society, the financial status

of the intermediary in a without-project situation must be analyzed carefully. If operational losses have to be balanced by regular external capital inflows, then the prospects for successfully strengthening banking for the poor should be viewed with caution.

Inadequate Deposit Mobilization Efforts

17. A broad consensus has emerged on the importance of deposit mobilization. The arguments in favour of an enhanced savings promotion in low-income countries are well known[7]. Deposit services are inadequate in rural areas in spite of existing demand; regular saving instills thriftiness and precludes excessive consumption by household members with privileged access to household incomes; it also provides security against theft. In the context of this paper, it may suffice to add to the current discussion that (a) from the PFIs perspective, a full service package for rural customers is evidently incomplete unless it includes deposit services, since a significantly higher proportion of villagers demand deposit services than access to loans; (b) if access of the PFI to external funds is governed by market prices for funds, then the opportunity costs of foregoing savings mobilization efforts will increase; (c) decentralized decision structures and maneuverability of the PFI may increase considerably if it can command its own resources rather than just administer and allocate external sub-loan funds; and (d) inadequate deposit mobilization also deprives the institution of a valuable customer information base.

Weaknesses in Customer-orientation, Product Development and Marketing

18. Financial services, offered in a competitive financial market environment, have to be based on customer demand in order to secure and increase the market share and thus the sustainability of the institution. Credit quotas, centralized and inflexible financial products, and disregard for services oriented towards effective demand constitute one of the major weaknesses in rural financial institutions. Deposit services have to be accessible in terms of minimum initial and running balance requirements, savings should be easily withdrawable and administrative procedures for opening and utilizing a savings account kept to a minimum. Demand-oriented credit services and disregard for services oriented towards effective demand constitute one of the major weaknesses in rural financial institutions. Deposit services have to be accessible in terms of minimum initial and running balance requirements, savings should be easily withdrawable and administrative procedures for opening and utilizing a savings account kept to a minimum. Demand-oriented credit services should reconcile cost and risk considerations of the financial institution with customer preferences. Cost-covering and risk-adjusted interest levels will ensure better access to loans than subsidized credit lines that are utilized over proportionally by wealthier villagers. Repayment periods matching positive cash flows of investments, timely availability of loans, and collateral arrangements which take into account the asset limitations

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[7] see for example R.C. Vogel "Savings Mobilization: The Forgotten Half of Rural Finance". In D.H. Adams, D.H. Graham and J.D. Von Pischke *Undermining Rural Development with Cheap Credit*, 1984.

of resource-poor households, are additional loan contract components which have to be tailored to customer demand while at the same time safeguarding institutional viability[8].

19. In selecting the appropriate financial institution for an IFAD-project, the following issues have emerged as important during the project preparation and appraisal stage:

Overburdening of Financial Intermediaries by the Project

20. Successful financial intermediaries serving small customers in rural areas are in danger of being weakened by unbalanced inflows of external capital. Management capacity may be strained beyond reasonable levels if external sub-loan funds greatly exceed ordinary lending volumes. Monitoring and reporting requirements of a project often involve additional costs and staff allocations. Screening of project borrowers and requirements for loan supervision and loan enforcement may also easily exceed available staff resources.

Underestimating Costs and Risks of Serving the IFAD Target Group

21. Providing savings and credit services to the rural poor poses a major challenge to soundly-managed financial intermediaries. Without project assistance, ,the poor are not serviced at all by financial institutions or they are carefully blended into a wider customer profile. If cost and risk implications of reaching out to IFAD project beneficiaries are not properly accounted for in project design - and also during implementation -, then sound rural financial intermediaries are in danger of being weakened by external projects.

22. Appraisal of PFIs during project design is usually facilitated by resorting to a detailed financial statement analysis. Annual reports of prospective PFIs contain the necessary financial status figures. Specifications in the national banking legislation should be emphasized to outline limits of financial status figures. Available data should be audited and analyzed in a time series format, comparing developments of key performance figures over the previous years.

23. The following lessons can be learned regarding the identification and assessment of the service capacity of a I FI: In providing financial services to the poor, prudent banking principles are even more important than when dealing with a broader mix of rural deposit and credit customers. A temporary strengthening of weak institutions or, on the other hand, a permanent weakening of strong institutions may be the result of conventional interventions which disregard the cost and risk dimensions of servicing the rural poor. Observations from the field confirm that financial institutions generally do not deliberately discriminate against the rural poor. Rather, cost and risk considerations determine cautious bank policies towards low-income groups. Only in those cases where market outreach

[8] R. Zander: Barriers to Credit Access - the Case of Rural Sri Lanka. In: Bouman and Hospes, Westview Press, 1994.

considerations of winning over and graduating future savings and credit customers serve as an entry point of banking with the poor, the thrust of IFAD in providing financial services will be parallel with the business interests of PFIs.

Box 1: Maldives

The Bank of Maldives Reaches Out to Poorer Customers

IFAD Ln. 249, The Atolls Credit and Developing Banking Project, has been effective since 1990. It is a successful example of a commercial bank furthering its customer base by including resource-poor customers from remote locations. The IFAD loan finances a special outreach programme of the Bank of Maldives Ltd. with significant initial successes in providing deposit and credit services for people hitherto beyond the reach of this commercial bank. By successfully tailoring financial services to low income customers, the bank has perceived the IFAD loan as a market development initiative which eventually aims at graduating the IFAD target group into their normal deposit and credit business.

2.4. Weaknesses in Conventional Strategies: Policy Level[9]

24. Establishing a proper fit between the project and the policy and institutional environment constitutes a third and final decisive ingredient, once demand at the household level and a suitable partner institution in the field are identified and assessed. IFAD investments are usually project-specific with limited direct exposure for sector loans. Both the loan volume and the project orientation make it unlikely for the Fund to have a major influence on financial sector policies of recipient countries. IFAD project preparation at policy level will therefore be primarily directed at identifying strengths and weaknesses in institutional structures and existing financial sector policies and at defining opportunities and possible constraints for the project under design. This policy level analysis of opportunities and constraints for project implementation requires more attention than it currently receives in IFAD project documents. Constraints may include an inadequate regulatory structure to supervise financial institutions, non-economi criteria for institutional development, legal gender discrimination, disequilibrium in interest rate structures and related legislation that promotes distortive effects of financial sector development (excessive reserve requirements of the Central Bank, etc.).

25. The policy environment in recipient countries is volatile. Interest rates, terms of trade for agricultural products, and policy priorities can change in the period between project identification and loan effectiveness and also during project

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[9] IFAD is concurrently preparing a separate study "Financial Sector Reform and Innovations: Issues and Options for IFAD" which elaborates in closer detail policy issues related to rural financial services promotion.

implementation. The specifications required in Appraisal Reports and Loan Agreements usually leave less room for flexible responses to changing policy environments than is the case for grant-based development agencies.

3. Evolving Experiences and Strategy Elements for IFAD Operations

3.1. Evolving Experience of the Fund in the Provision of Financial Services

26. Targeting impoverished and resource poor sectors of the rural population with viable and accessible services poses a major challenge to project investments of the Fund. At the same time, IFAD's role has been that of a catalyst in identifying financial mechanisms for the rural poor which may open new avenues for sustainable development.

27. This section outlines lessons learned and evolving approaches as a result of 15 years of experience in promoting financial services in low-income countries.

Diversity of Institutional Mechanisms

28. IFAD cooperates with a wide range of institutions who are experienced in servicing the poor. Most of the projects cooperate with banks, either with a universal commercial orientation (e.g., Nigeria, Maldives, Honduras) or with parastatal banks oriented towards the agricultural sector (e.g., Ghana, Nepal, Nicaragua, Jordan). More recently, thrift and credit cooperatives, credit mutuel and other forms of single-purpose savings and credit cooperatives have been increasingly supported (e.g., Rwanda, Sri Lanka, Equador, Sudan). NGOs have been promoted in single instances as financial conduits for extending deposit and credit services to the poor (Senegal, Pakistan), when no alternative mode of financing appeared feasible.

Do the Poor Need Separate Financial Institutions?

29. The Fund's experience has shown that institutions which serve the poor exclusively may have limited prospects of viability after project completion. Although in Asia a few IFAD projects which focus exclusively on the poor operate successfully (initial successes of the Grameen Bank in Bangladesh), PFIs with a wider customer clientele have generally fared better and maintained their operations independent of external support. A proper customer mix has indeed many advantages: wealthier villagers can utilize deposit facilities which in turn serve as lending pools to the target group; the term structure of deposit and lending instruments is more balanced with a variety of customers and service demand structures; finally, operational risks are spread more evenly with a heterogeneous customer base. There are also other implications which reach beyond a purely economic dimension: poorer people banking with the same institution as their more prosperous fellow villagers develop a sense of self-esteem which an isolated institution exclusively for the poor does not provide; and they

can continue banking with the same financial institution once they have graduated into the mainstream of rural development.

Group Lending versus Individual Lending

30. Group formation for self-help activities among the poor constitutes an integral part of most IFAD projects. Groups are used in a bid to overcome access barriers to rural financial services and to reduce transaction costs for borrowers and lenders alike. Joint liability for loan repayment is supposed to serve as a collateral substitute with peer pressure among group members being the main mechanism for reducing loan delinquency. However, experience in channelling financial services through groups indicates the following:

(a) *Design of Group Savings and Lending Components.* Generally, full and mandatory joint liability arrangements have not contributed to viable savings and credit groups. Wherever one group member is responsible for the repayment of every loan made to the group, a good individual repayment record is sanctioned and default is not discouraged. As a consequence, the phenomenon of "adverse selection" may occur, with responsible borrowers leaving the group. Further, when loan sizes increase upon successful repayment of previous advances, care has to be taken that larger loans do not eventually exceed the risk-bearing capacity of small borrowers. Deposit components work best if savings can be withdrawn at any time, if groups act as a link to a financial institution which safeguards the security of deposits, and if saving is an end in itself rather than only a collateral build-up for advancing loans.

(b) *The Process of Group Formation.* The creation of too large a group is generally not conducive to good repayment morale. Furthermore, if the group composition is not self-selected but externally imposed, solidarity among group members may not be forthcoming. In some situations, the target group may also have reservations about the promotion of services through groups. Unless group formation responds to the demands of project participants, creates tangible benefits and can be accommodated into their daily routine, some caution should be exercised in utilizing the group mechanism for financial services in IFAD projects.

(c) *Promising Group Structures.* Successful savings and credit groups reaching out to the poor require specific skills in managing loans and deposits. They require adequate, simple but effective systems and procedures tailored to the needs of their members. Village-based savings and credit groups also require regular guidance in the fields of strategic planning, management and control and, in particular, in auditing. Ideally, such services would be provided by a local or national umbrella organization, financed and controlled by the village based member groups. IFAD experience indicates that the thrift and credit cooperative model is one potentially promising option to meet these challenges. Single purpose cooperatives for financial services are governed by their members and supervised by local and national umbrella

bodies. Thrift and credit cooperative groups are, for the rural poor, an entry point into the mainstream of financial services supporting values of thrift and the proper use and repayment of small-scale loans. The TCCS movement in Sri Lanka (see Box 2) represents probably the most notable example of a successful, self-propelled thrift and credit cooperative in rural areas. IFAD works with the TCCS in Sri Lanka and also supports thrift and credit cooperatives in various other countries.

Box 2: Sri Lanka - Thrift and Credit Cooperative Societies

Several IFAD projects (Ln. 179 Kegalle Rural Development Project; Ln. 219 Small Farmers and Landless Credit; Ln. 283 Second Badulla Integrated Rural Development Project; Ln. 309 North Western Province Dry Zone Participatory Development Project) currently provide financial services to the disadvantaged rural groups through the Thrift and Credit Cooperative Societies (TCCS). Established as early as 1911, this single-purpose savings and credit cooperative movement has experienced a remarkable revival during the last fifteen years. Due to voluntary management and meeting facilities provided by members, village-based primary cooperatives operate at exceptionally low costs. Loan and deposit contract components vary from village to village, since primary cooperatives establish their upper borrowing limits and interest rate spreads individually. Village groups advance loans exclusively from advanced savings capital. The District and national umbrella structures service the needs of village cooperatives in the areas of auditing, training and liquidity management. Repayment rates and target group outreach in the Small Farmers and Landless Credit Project (Ln. 219), which became effective in 1989, encouraged the Fund to involve TCCS to a larger degree, in subsequent IFAD investments in Sri Lanka. The primary cooperatives proved resilient in providing deposit and credit services even during a period of political unrest in the South Western part of Sri Lanka in the latter part of the eighties.

31. *The Role of NGOs in the Provision of Financial Services.* IFAD gives strong emphasis to involving local Non Government Organizations (NGOs) in projects. Local NGOs can be a formidable vehicle for conveying the views and wishes of the poor. Awareness and skills development programmes of NGOs have significantly contributed to improved living conditions of the poor in projects supported by IFAD. Some NGOs also offer deposit and credit services to villagers, in many cases exclusively to low-income groups. Since these activities are only a small part of a multi-purpose approach of NGOs which do not recruit staff with a banking background and are not geared to professional financial umbrella organizations for training, accounting and auditing services, IFAD attributes a major role to NGOs mainly in the field of identifying, training and graduating potential borrowers and depositors. The core business of lending and managing deposits is, however, entrusted to bank or non-bank financial institutions.

32. *The Gender Dimension.* The history of IFAD projects with significant components for rural women from low income groups began almost simultaneously with the first investment activities of the Fund itself. The portfolio exposure for the inception of the Grameen Bank with four out of five borrowers being female, constitutes probably the best known project with gender-based lending activities.

33. More recently, the Fund's high profile in thrift and credit cooperative development has opened another avenue in supporting rural women with financial services. Poor rural women are known to feel more comfortable dealing with their village savings and credit group than a fully-fledged bank. In many cases, women represent a superior pool of customers since they are known to save regularly and to honour their commitments to prompt repayment of loans. Women have been targeted in two ways in IFAD's rural credit projects:

(a) Sub-loan components target women exclusively and directly. The rationale for this first approach is that customary structures in rural financial systems which favour men are directly offset and counterbalanced.

(b) The provision of equitable and accessible financial services for rural women is part of a consolidated approach which is gender-neutral but ensures equal access and benefits for both rural women and men.

34. Since the late eighties, the Fund has initiated an internal discussion on the merits of both strategies. As a result, the latter strategy is presently the one generally followed. A "level playing field" for male and female customers turned out to be more effective in promoting the advancement of women than a gender-discriminatory support strategy with sometimes adverse, socially divisive effects.

3.2. Evolving Elements of A Strategy for Financial Services Promotion

35. Based on the weaknesses in conventional project design highlighted in chapter 2 and IFAD's evolving experiences in the provision of financial services (section 3.1.), six key strategic elements for the design of a sustainable financial service structure for the poor are identified below.

ELEMENT 1

costs and risks assessment

consideration of the two key success variables of rural financial intermediation

36. Focusing on costs and risks of existing as well as potential project-induced activities of a Participating Financial Institution is a simple starting point for financial services promotion in a project context. However evident the need for sound cost and risk assessment and management may be, cost and risk considerations often rank far behind credit delivery target orientation and overly ambitious design without due regard for the service capacity of the PFI.

ELEMENT 2

responsive service structures

understanding, sharing and incorporating priorities of PFIs and project participants

37. The need for a responsive project design arises at two levels: first, between the PFI and project designers/implementers. Only if an external development intervention takes into account the priorities, constraints and potentials of a PFI, will it reach a confluence of interest between local institutions and project designers. The second level of creating responsive service structures relates to the relationship between the PFI and project participants. IFAD projects are characterized by a strong emphasis on beneficiary participation during project planning and implementation. The greater the responsiveness of project supported institutional services to beneficiary priorities, the greater the prospects for a durable project impact.

ELEMENT 3

customer protection

protective arrangements for project depositors and borrowers in order to establish and maintain a relationship of confidence between the PFI and project participants

38. The newly emerged consensus on the need for savings mobilization to complement credit services is increasingly being put into practice; but the mere mobilization of small-scale deposits is only part of a comprehensive savings service package. Petty savings from resource-poor households need prime protection against loss of deposits. Misappropriation in savings and credit groups as well as imprudent lending from internally generated deposits threaten the security of savings accounts. Borrowers under a project umbrella require customer protection as well. They have to be shielded against the risks of project-induced investments. Whenever a beneficiary bona fide follows project recommendations which result in repayment difficulties, borrower protection techniques should be incorporated into the financial services package. The IFAD Project Risk Fund is an example of improved financial technology in a project context[10].

39. Borrower screening represents the first stage of a loan transaction. The success or failure of a loan depends to a large degree on an accurate appraisal of the customer's repayment capacity. Weaknesses at this early stage of credit management can determine the status of repayment and thus the viability of the intervention. One decisive element of credit design is therefore to entrust borrower

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[10] Ph.K.H. Bechtel and R. Zander, ibid.

ELEMENT 4

prudent borrower screening techniques

Assessing effective credit demand based on repayment potential requires financial skills with techniques based on professional banking principles

screening only to staff of financial institutions with the necessary skills and experience. Both bank and non-bank financial institutions, like thrift and credit cooperatives, are suitable for the job. NGOs, laymen village committees or other arrangements might be used only in identifying borrowers to be screened later by the staff of financial institutions. Loan applicants should be screened according to the repayment generating potential and their household asset and liabilities status. The resulting net worth of an applicant provides important information on his potential repayment capacity and is more encompassing than relying only on an analysis of expected net cash flows of an investment.

ELEMENT 5

refinement of successful financial institutions

Identifying financial institutions already providing services to resource-poor households; supporting them in their outreach to low-income clients

40. The demanding task of providing financial services to resource-poor households can best be met by involving financial intermediaries with an already established record of servicing the IFAD target group. <u>Formal financial institutions</u> with a track record in cost and risk management should be assisted in finetuning their planning, management and control techniques. <u>Informal financial institutions</u> are often the only option for the IFAD target group in gaining access to credit and also deposit services. However, the very flexibility of their operations, a quick adaptation to changing opportunities and constraints, and the nature of their operations outside the legal framework render possibilities for project inclusion limited. If informal financial intermediaries are included in the project design, arrangements for protection of clients' deposits, assessment of their capacity to attend to diversified customer demand and liability arrangements require particular attention.

ELEMENT 6

sustainability

the viability of project-supported financial service structures after project completion

41. The most crucial overall element concerns the long-term impact of savings and credit promotion by IFAD. The impact on incomes, household food security and the social status of beneficiaries beyond project completion is a necessary but not a sufficient measurement of sustainable project impact. Equally important is the viability of the service structure initiated or strengthened by IFAD. Unless project participants have continued access to deposit and credit services after project completion, the IFAD investment will not have a sustainable impact.

4. Summary

42. The paper first identifies shortcomings at different levels of project design. Experiences and evolving approaches emanating from present constraints illustrate that emerging weaknesses in providing financial services to the rural poor offer challenges and opportunities. The paper argues that a strategy based on the five basic elements outlined in chapter 3 with the ultimate objective of sustainability and available and accessible financial services is well placed to respond to the requirements of rural low income customers. Due regard to the basic considerations of costs and risks, service structures that are responsive to the effective deposit and loan demands of rural low income customers, sound screening techniques with adequate arrangements for customer protection, and a cooperation with financial institutions that already operate successfully - these constitute the basic elements for improved project quality with the ultimate aim of contributing to sustainable rural poverty alleviation.